

**OVERSIGHT OF THE PENSION BENEFIT GUARANTY
CORPORATION, 1982**

**HEARING
BEFORE THE
SUBCOMMITTEE ON LABOR
OF THE
COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE
NINETY-SEVENTH CONGRESS
SECOND SESSION
ON
EXAMINATION OF THE PENSION BENEFIT GUARANTY CORPO-
RATION PREMIUM INCREASE**

MAY 19, 1982



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OVERSIGHT OF THE PENSION BENEFIT GUARANTY CORPORATION, 1982

WEDNESDAY, MAY 19, 1982

U.S. SENATE,
SUBCOMMITTEE ON LABOR OF THE
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, D.C.

The subcommittee met at 9:32 a.m., in room 4232, Dirksen Senate Office Building, Senator Don Nickles (chairman of the subcommittee) presiding.

Present: Senator Nickles.

OPENING STATEMENT OF SENATOR NICKLES

Senator NICKLES. Good morning. Today is the seventh and final day of hearings this subcommittee has held on the Employee Retirement Income Security Act, known as ERISA, during the 97th Congress.

Today we will consider the pending request by the Pension Benefit Guaranty Corporation (PBGC) to increase the single employer premium from the current \$2.60 to \$6 per participant per year. This is not a very steep increase request, and the Corporation will testify to document its case.

A new light has been shed on PBGC following the financial collapse of Braniff International. Should Braniff terminate its pension plan, published reports indicate that action would add almost \$70 million to the liabilities of the PBGC. The Corporation is already running a long-term deficit of about \$190 million—that is, if it had to meet all its liabilities at one time, it would not be able to meet its obligations.

The requested increase may well be warranted, but rest assured that this subcommittee will closely scrutinize the proposal before determining our course of action.

A more troublesome aspect of these hearings are the loopholes in current law that permit abuse of the system. We heard testimony last November that demonstrated how a company could terminate an underfunded pension plan and thereby transfer its liabilities to other employers, and do this under the guise of a good business decision. This is ludicrous, and certainly not beneficial to the business community as a whole, or to beneficiaries.

Clearly, this subcommittee has but one recourse. That is to produce legislation that precludes these abusive practices.

I have read the testimony of each of today's witnesses, and some very good points were raised. I recognize that the statements were

put together without the benefit of knowing the justification PBGC will outline this morning concerning its requested increase—and it is likely that after hearing their argument we all might have some change of opinion. We will welcome any additional comments for the record that people may have after reviewing PBGC's statement this morning.

I would also like to thank the many individuals who have given an enormous amount of the time to me and my staff in preparation, not only for this morning, but also in the work that we have been doing in ERISA.

It is my hope and my contention that this committee will be successful in coming up with a bill that is possible, a conscientious bill that we will be able to move through this session of Congress that will address many of the issues that I have alluded to, and also to see if we cannot get the PBGC on a more sound actuarial basis.

The first witness we have is the new head—and I will congratulate formally Mr. Jones, who is now the Executive Director of the Pension Benefit Guaranty Corporation.

Mr. Jones, if you would introduce the people that are with you and please proceed.

STATEMENT OF EDWIN M. JONES, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION, WASHINGTON, D.C., ACCOMPANIED BY HENRY ROSE, GENERAL COUNSEL; GERALD COLE, ASSISTANT EXECUTIVE DIRECTOR FOR POLICY AND PLANNING; LAWRENCE MASLAN, DIRECTOR, OFFICE OF FINANCIAL OPERATIONS; AND JOHN HIRSCHMANN, CHIEF, DIVISION OF FINANCIAL AND ACTUARIAL PROGRAM DEVELOPMENT

Mr. JONES. Thank you, Mr. Chairman, and good morning. We are delighted to be able to testify today.

As you indicated, we are looking forward to working closely with you in developing appropriate legislation to insure the continuing protection of all of the workers who are protected by this system. We have had already the pleasure of dealing with your very competent staff, and are glad to continue to do so.

With me today are Lawrence Maslan, on my right, who is head of our Financial Operations; Henry Rose, on my left, who is our General Counsel; Gerry Cole, on my far left, who is the Assistant Executive Director, Office of Policy and Planning; John Hirschmann, on my far right, who is the Chief of our Division of Financial and Actuarial Program Development. They have been very directly involved in the preparation of the detailed report which has been submitted to you and to other Senators and Congressmen.

We also have with us some of the individuals who have done a lot of work, like Don Armstrong and Ralph Kelley and Melanie Nussdorf. With us, too, is Preston Bassett, who has been an actuarial consultant to the PBGC. He is a fellow of the Society of Actuaries and well acknowledged in his field, and has been consulting with us in the development of this report,

Senator NICKLES. Could I get his name again?

Mr. JONES. Preston Bassett.

Senator NICKLES. How long has he been doing this?

Mr. JONES. He has been with the Corporation during the development of this report and has been a consultant for sometime on various matters.

Senator NICKLES. With PBGC for the last couple of years?

Mr. JONES. How long has it been, John?

Mr. HIRSCHMANN. Mr. Bassett has been consulting with us on this premium study for the past couple of months. He has reviewed the work that we have done.

Senator NICKLES. Thank you.

Mr. JONES. Coming to our own story today, we would like to discuss the very critical needs facing the Single Employer Pension Plan Termination Insurance System to which you have alluded, Senator.

Senator NICKLES. Could you pull that microphone up so that our people in the back will be able to hear you as well?

Mr. JONES. Annual premiums from plan sponsors provide the funds which the Pension Benefit Guaranty Corporation needs to protect participants and beneficiaries in terminated defined benefit pension plans against loss of their basic pension benefits.

In 1974, when ERISA was passed, the annual premium imposed by Congress on single employer plans was \$1 per participant per year. By 1977, when it became clear that the premium was not adequate to cover claims against the system, the annual premium was increased by Congress to \$2.60 per participant, effective January 1, 1978.

Since the 1977 premium increase, we believe that events substantiate the need for an increase as soon as possible.

Speaking first on a per plan basis, the average claim against the Corporation from terminating plans is currently over \$1 million compared to just under \$300,000 in 1977. On a yearly basis, in the last 4½ years, net claims for benefits against the Corporation have increased to an annual average level of \$62.3 million from the \$24.7 million annual average during the first 2½ years of the Corporation's experience. That is up about 2½ times. This 2½-fold increase in net claims alone from the time of our last premium increase is more than the requested 2⅓-fold increase in the premium level.

Now, if we can, let us dwell 1 minute on claims just to be sure that we are understanding what each of us is talking about and what we mean by claims. In somewhat technical terms, the amount of claims incurred by the Corporation is equal to the present value of basic benefits in terminated plans that will be paid over a series of years, less the sum of plan assets turned over to the Corporation on plan termination and less any amounts recovered by the Corporation under the employer liability provision.

Now, perhaps it might help to give a little example for clarification purposes. If, for example, we had 100 plan participants under a terminated plan, and we were going to pay them \$1,000 per participation or a total of \$100,000 a year, we would be paying those people over a period of years—on the basis of various estimates as to mortality and length of life—about \$1,400,000 under the assumptions underlying these calculations. We take that \$1.4 million and reduce it to a present value on the basis of a discount factor—we have used 10¼ percent—producing a present value of claims of

about half a million dollars. So it is that figure of \$500,000 that we are talking about in terms of claims.

Senator NICKLES. That would be, Mr. Jones, for a person who would receive how much a month, at age 65?

Mr. JONES. In our example, we took 100 people; we took 50 who are receiving an immediate annuity of \$1,000 a year, and we took another 50 who would be receiving an annuity 10 years from now because we assume they are age 55. It would be \$1,000 a year for all of them.

Senator NICKLES. I have done a little actuarial work just to see if we are similar. If a person is going to receive \$1,000 a year at age 65, the present value of that at age 65 would equal what?

Mr. JONES. Well, for a particular person, if you were to compute the present value, you would have to use ordinarily—let us assume he is a healthy person and you would have an ordinary mortality table. These are not exact, but it would be in the neighborhood of a life expectancy at age 65 of, say, 15 years; you would be paying \$15,000 to that man or woman. You would bring that \$15,000 back to a present value.

Senator NICKLES. Present value?

Mr. JONES. And the present value of that would be—John, what would you say the present value of that would be?

This is Don Armstrong, our actuary.

Mr. ARMSTRONG. At 10 $\frac{1}{4}$ percent, the present value for a male, age 65, would be 7.0347.

Senator NICKLES. For each dollar?

Mr. ARMSTRONG. For each dollar per year.

Senator NICKLES. Seven what?

Mr. ARMSTRONG. 7.0347.

Senator NICKLES. Do you use the same thing for male and female?

Mr. ARMSTRONG. This factor is for a male, age 65. For a female, the factor would be different.

Senator NICKLES. I just want to be sure.

Mr. JONES. That would figure out then to \$7,000; is that correct?

Mr. ARMSTRONG. Right.

Mr. JONES. All right,

Now, that is the past claim picture. Let me dwell on one other issue of the background that we think is significant to the understanding of the present situation and our request.

The growth in net claims during this period of time that we alluded to has been such that, as of September 30, 1981, that is the Corporation's fiscal year end, the Corporation's deficit was \$189 million. You had referred to that figure before. That deficit is projected to increase to \$236 million by the end of calendar year 1982.

Now, by comparison, when we last appeared before Congress, the deficit was \$41 million and, at that time, our studies specifically indicated that the increase that was requested at that time was specifically intended to be adequate through 1981. We did not project beyond that time.

Senator NICKLES. What year was the deficit \$41 million?

Mr. JONES. The \$41 million deficit was existing at the time we came to Congress in 1977. It would have been at the end of year end 1977.

Mr. HIRSCHMANN. \$41 million was the deficit at the end of fiscal 1976. At that time, we were projecting that it would go to \$60 million by December 31, 1977.

Senator NICKLES. You said end of the year, and I was not sure what year.

Mr. JONES. The point he is making is that the \$41 million was the deficit at the end of fiscal year 1976, but we were also, at that time, projecting an increase to the end of the calendar year like we are doing now. At that time, the deficit projected was from \$41 million to \$60 million, and now we are saying \$189 million to \$236 million.

That deficit represents the amount by which the present value of the Corporation's benefit claims exceeds the assets of the Corporation. More specifically in dollar terms, the present value of all of the Corporation's liabilities was \$715 million at the end of September 30, 1981. The total assets were \$526 million, and the difference is \$189 million. That is the deficit that we are talking about as of September 30, 1981.

Now, looking forward into the next 5 years, our Board of Directors, and that is Labor Secretary Donovan, Secretary of the Treasury Regan, and Commerce Secretary Baldrige, after careful consideration, believe that the granting of this premium increase to \$6 per participant in single employer plans is essential if the Corporation is to maintain the integrity of the system for the some 28 million covered single-employer plan participants, and if we are to fund our obligations in what we consider to be a fiscally prudent manner.

Now, the Corporation's premium study, which has been given to you, discusses in greater detail, the basis for the forecast that a premium increase to \$6 would cover projected new benefit claims through the end of 1986. That is, the claims that we have computed the way we described before. That premium would also amortize by the end of 1987 the \$236 million deficit that we project will be in existence at the end of our calendar year 1982.

The \$6 premium is not designed to cover benefit claims of an unprecedented large nature, which may eventuate, but the \$6 premium does allow for the expectation and projection that claims of normal size will increase. It will permit the Corporation to retire its deficit over a 5-year period.

Now, you may ask, what will the \$6 be used for? And I would like to break that down into the principal components. Slightly over half of the premium is devoted to financing and meeting the future claims that we have just described.

As we noted earlier, our average benefit claims had grown from \$24.7 million for the approximately 2½ years from the inception of the Corporation through March 1977, and to \$62.3 million for the most recent 4½ years through 1981.

Now, we have a chart that endeavors to graphically illustrate the annual premium, and the average claims.

Now, the first bar is the figure of \$24.7 million and the second bar, and that is for the period from 1974 to 1977. The second bar is for the period of 1977 to 1981.

Now, the top part of the bar is the plan assets where they start with a gross claim figure of \$68.5 million. Now, the top hatch part

is the plan assets. The middle part, the white part, is the employer liability that we expect to recover and the bottom part is the net claims.

You will notice that in that period of time we had net claims equal to 36 percent of the total gross claims of \$68.5 million. That is the bottom hatch. And then when we move over to the next period up through 1981, the net claims reached about 56 percent of the total gross claims of \$113 million which is the top of the second bar. Our assets went up in dollar amount but that is the plan assets that we recover, but they went down a slight percentage of the total gross claims, from 42 percent in the earlier years to about 40 percent in the more recent period of time.

Now, based upon that past experience and other factors which are quite numerous, which enter into this picture, we have concluded that it would be reasonable and prudent to assume that that upward trend that we saw there in the earlier years will continue, and on the basis of our claims experience and the studies that have been done, we expect the claims will increase by about \$8 million per year. At least we project that increase as a reasonable expectation, based on what we have seen in the past.

Senator NICKLES. Has that been the average?

Mr. JONES. Yes, it has. You will find the second chart there that we have that is now on the easel adds to the dimension of the first chart, a third bar. The third bar is the higher one there and you will notice if you just inspect the chart that there is a rough projection line that is quite steep, and it has been going up that way for a period of time. Let me just point out that that total bar on the right shows a projected gross claim figure of \$169 million as against \$113 million. This is average annual, do not forget, of which we hope to get plan assets of about 39 percent of that sum, the employer liability would give us 5 percent and we would have net claims equal to the balance. And that would be about 55 percent of the \$169 million figure.

I might ask in direct reply to your question, John, in the figures that represent our increase of \$8 million per year going forward, which reflects about a 9-percent increase for that period of years, is it true that the 9 percent is also approximately where we have been in the past or, if not, what is that figure?

Mr. HIRSCHMANN. The analysis that we did, rather than take the figures summarized in these two charts, we actually took the claims for each of the 7 years for which we had experience, analyzed its components and found that over that 7-year period there was a statistically significant rate of growth which, as Mr. Jones mentioned, was about \$8 million a year or, converted to percentage basis, 9 percent a year.

Senator NICKLES. I am not wanting to interrupt your statement with questions.

Mr. JONES. Fine. Glad to have it.

Senator NICKLES. But, correspondingly, are you forecasting an increase in the number of participants, decrease stabilization or what?

Mr. JONES. On the participants, we are projecting an increase in the number of participants, that gets into the projection of the premiums we will receive. We are expecting an increase to 32 million

participants from 28 million participants. That is an assumption that obviously impacts on the \$6 figure. If we do not get that increase in participants, we will not have as many \$6 being received.

Senator NICKLES. Moving from the present 28 to 32—

Mr. JONES. Roughly, yes.

Senator NICKLES. All right.

Mr. JONES. Now, just to recapitulate a bit, while we have had these benefit claims increasing, assets of terminated plans taken over by the Corporation have remained a relatively constant percentage of the total guaranteed benefit claims, and that is indicated in the figures in the chart. The result is that the amount of plan underfunding per participant has increased, and we have no doubt that benefit claims against the Corporation will continue to rise. Increases in benefit claims are consistent in concept with increases in other components of the total compensation package, such as wages and welfare benefits and the like, all of which have been increasing in dollar terms to maintain compensation levels.

Now, when we take that \$8 million increase per year, Senator, and project it forward into the future, it produces an average annual level of net claims in the years 1983 to 1986 of about \$96.8 million. Now, when this sum is divided by the 32.1 million participants which we just mentioned, and that is how it impacts this figure, when we divide that \$96.8 million figure by 32.1 million participants in the single employer defined benefit plans in those years, the resulting required premium to meet future claims is \$3.02. That is the claim part of our premium. Now, to this figure there must be added, if the Corporation is to retire the projected 1982 year-end deficit of \$236 million over 5 years, an additional annual premium of \$1.95 per participant.

The third component is the administrative expenses that have been projected on the basis of approved OMB figures for 1982 and 1983, and on the basis of the 1983 budget, increased by projected increases in the Consumer Price Index through 1986. The resulting required annual premium on that basis, which is required to cover the projected administrative costs, is 97 cents per participant. So we take the total of the three components, the \$3.02, the \$1.95 and the 97 cents and we come to \$5.94, which we rounded to \$6. To put that \$6 in context, it does represent an increase of \$3.40 over \$2.60, but the total premium is less than 1 percent of annual pension benefit costs. It is really only a tenth of a percent of all employee benefits, about three-tenths of a cent for every hour worked, and about four one-hundredths of 1 percent of annual payroll costs. Those are pretty technical terms—they certainly sound low to me, but I also think a little bit more simply, after all, we have a \$3.40 increase and we are talking per person per year. And that really is not a great deal more than the cost of a decent hamburger and in terms of the economics that we are up against at this time.

So I think that—and there are any number of other examples that can be given, but we certainly think it is a relative figure and not one that is out of line in terms of our projected needs.

The goal here and the concept in underlying these figures is that the premium increase, if the assumptions we have made are actually realized, would place the Corporation's insurance program for

single employer plans on a sound financial basis which would be appropriate under prudent insurance concepts.

Looking over to the insurance world at this point, we think that if a private insurance company were in the business of offering this type of annuities, this is the kind of a deficit that never would have occurred in the first place. The insurance company would be getting a premium that is equal to the present value of the expected stream of payments that they need to pay out over a period of years. They would add to that premium an appropriate amount for the administrative costs, and that would never produce a deficit on a typical type of case.

Now, what we are trying to do is get back to where we really should not be in the first place. The total deficit is something that represents a loss to us and it is one that which we want to retire in an appropriate period of years. So we think that the goal of eliminating that deficit as soon as possible is a very important goal to attain.

We would like to do it faster if we could but, after you consider a whole range of matters that impact this situation, we come up with a 5-year period as a fair and reasonable result under all the circumstances. We have in mind that it is equitable to retire the deficit as fast as we can. The most equity would be done perhaps if we went back and recast the premium over the last 5 years and really went back and charged everybody that was part of the system and paid the lower premium at that time. We cannot do that, but we can go forward and get it back as fast as possible.

But, from an equity point of view, the companies paying the premium ought to be paying it concurrently with the development of the losses.

I might point out that in the regular insurance world, the premium that is often fixed carries with it a safety margin, which is often not needed and often, in at least mutual companies, comes back in the form of a dividend. We do not have that concept here. That is another reason why we think the increase is certainly not a large increase in consideration of all the facts and circumstances that we have to keep in mind.

Now, in the broad terms, at the end of fiscal 1981, the Corporation was responsible for the guaranteed benefits of 80,000 persons; that is 39,000 retired people and 41,000 with deferred vested benefits. Payments are currently being made under terminated insufficient single employer plans to slightly over 39,000 people, that is, retired participants, in an amount which totaled \$57 million in fiscal year 1981 and may approximate \$75 million in fiscal year 1982.

Now, the Board of the Corporation, and all of the officers, including myself, feel that the responsible way in which to run this Corporation is to attain as rapidly as possible a current funding status for the Corporation. That objective translates into a financial condition in which the Corporation will have on hand at any point in time an amount of assets which, together with the expected return on their investment, will be sufficient to fund all liabilities that then exist at any given point in time. It is in this way, we think, that the premium payers in the future will not be required to assume what might be termed an unfair share of the burden of fi-

nancing the cost of past terminations of plans. Our approach should also lessen the need for a premium increase in the future.

In short, assuming that our projected future claims for benefits, the Corporation's administrative costs, its return on investments, and its mortality assumptions, turn out to be as projected, the \$6 premium will retire the deficit at the end of 5 years and bring the Corporation to a currently funded basis.

And, graphically, we have a fairly simple chart which shows that. The line on the chart that ascends sharply is where the deficit will be going with the current premium of \$2.60, and the line that is descending is where the deficit will be going with a \$6 premium.

Now, this particular goal is nothing new. The Corporation has consistently set the goal of achieving levels of premium income which are adequate to finance the liabilities that the Corporation is incurring on a current basis.

Now, if as events unfold, larger than projected claims are incurred by the Corporation, the deficit could increase during the 5-year period rather than decrease. And, likewise, larger than projected claims could be caused by a variety of factors, and these are mentioned fairly briefly, and they can be elaborated on. But, qualitatively, we have in the background the fact that there is an increased level of bankruptcies which we must take notice of. There is also a growing awareness by sophisticated plan sponsors that they can attempt to transfer much of their unfunded vested liabilities under existing law to the Corporation, by careful planning, which they can readily obtain from experts in the field.

A third factor is the attraction for plan sponsors to terminate overfunded pension plans and recoup plan assets for general corporate purposes which tend to weaken the Corporation's premium base over a period of time.

Another factor is the relatively low rates of funding being used to retire the presently existing unfunded vested liabilities in single employer plans. Another is the existence of statutory provisions in the Internal Revenue Service Code which permit plan sponsors, with the Internal Revenue Service's approval, to receive waivers of the minimum funding standards in hardship cases under certain conditions. Obviously, if the funding requirement is waived, there are less assets that go into the plan, there are less assets available to be recovered by the PBGC, if a plan terminates. And therefore there is a bigger deficit and a bigger net claim on our system which impacts on the premium level.

There is also a growing tendency of plan sponsors to raise the interest rates that are being used for calculating plan reserves. Those increases result in reducing a plan sponsor's required annual contribution, assuming other things remain the same, and essentially create a larger unfunded vested liability where the assumed higher rates are not in fact realized.

Now, in addition, even if claims did not increase above projected levels as we project they will, an insurer, such as our Corporation, must keep in mind in setting premiums that if lower than expected investment earning rates were to be achieved or unexpected mortality losses were to emerge, or administrative expenses were to in-

crease above projected levels, the deficit could increase during the 5-year period rather than decrease.

Now, under such conditions, the Corporation would have to address whether Congress should again be approached for action in connection with a further premium increase. In contrast, if the actual experience of the PBGC turned out to be more favorable than projected, which is an unlikely result during the next 5 years unless many changes are made in the law, the possibility of reducing the premium could be addressed.

Now, in short, we believe that the single employer insurance program should be financed so that achievement of the Corporation's goal of "current funding" within a 5-year period is made possible. Our overall goal is only to maintain a sound system of insurance, as mandated by Congress, so that the insurance guaranty expectations of some 80,000 participants of already terminated insufficient plans will be properly protected, and so that appropriate protection is provided to the 28 million participants in ongoing covered plans.

Now, the way to enable the Corporation to achieve that goal is to provide the Corporation with sufficient funding or sufficient premiums so that its assets will reach a level where they will be equal to the present value of the benefits that are payable to these participants for the remainder of their lives.

Now, on our part, with a premium increase, we are certainly going to do everything that we can do to address existing and potential problems as quickly and as thoroughly as possible. I, of course, am new on the job and have set as a matter of highest priority a careful study of the many issues that have been presented to me by knowledgeable representatives of many interests in the short space of time that I have been privileged to be Executive Director. Many of these people are in the room, and there have been many ideas presented by your staff, they are all great minds, and a lot of ideas will emerge. And we will certainly do everything we can to address them and provide whatever guidance we can to you, Senator, in coming up with what you consider to be the right solutions.

Now, I would like also to dwell for just a short space of time here. Time is of the essence in setting the effective date of the premium increase. We are asking for action so that it will be effective January 1, 1983.

I would note in this connection that title IV refers to an increase being adopted at least 30 days before the increased premium rate can be put into effect. The point we would like to emphasize is the longer the delay in increasing the premium, the greater will be both the insurance cost, and the resulting premium that will then have to be paid in the future, since the Corporation's deficit is projected to be increasing during the interim period.

For example, if the effective date of the premium increase were to be delayed 1 year from the requested date, the premium of \$6 would have to be increased to \$6.79 per participant to achieve the same results that we have been speaking about.

Furthermore, because 70 percent of the Corporation's premium income is derived from plans with premium years beginning in January, a delay of only 1 month in the effective date to February 1, 1983, would still increase the required premium level to \$6.56.

Senator NICKLES. Your point is well taken as far as time. And I want to make mention of the time because we have several other witnesses today.

Mr. JONES. Just a few more words here and I will be through, Senator.

This point has come up a number of times and we said that no allowance has been made for a reserve for claims of unprecedented size which may occur. Now, to set aside a reserve of \$1 billion for the next 4 years, our calculations indicate that the premium would have to be increased to \$12.64 per participant, effective January 1, 1983. We have not chosen to ask for that increase at this time. If they occur, then we will have to reconsider the matter.

One further brief word on pending legislation. The premium increase is founded on an assumption that our experience to date will not materially change. Without legislation, that assumption, we think, will not hold. It is an attractive option to terminate one's pension plan and obtain excess assets from it, where the amount is in excess of its liability to the Corporation, where 30 percent of the employer's net worth is less than what the Corporation is otherwise going to be liable to pay in benefits. Similarly, the sale of a business with large unfunded pension liabilities to a weak buyer allows the seller to insulate itself from employer liability.

There is no question that employers have become increasingly aware of that fact. And if these claims continue against the system, we do think that the premium that we seek today is not enough.

In this connection, Mr. Niskanen of the Council of Economic Advisers testified before you several months ago, and he made clear that certain changes in the law relating to the insurable event, adding a transfer rule and general creditor status for the PBGC, are essential to any adequate reform of the single employer plan program. We know that you are serious about these matters and we stand behind Mr. Niskanen's testimony, and I do wish to work with you on that.

[The prepared statement of Mr. Jones follows:]

TESTIMONY OF EDWIN M. JONES
BEFORE THE SUBCOMMITTEE ON LABOR
OF THE SENATE COMMITTEE ON
LABOR AND HUMAN RESOURCES

GOOD MORNING, MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE.

I'M EDWIN M. JONES, EXECUTIVE DIRECTOR OF THE PENSION BENEFIT
GUARANTY CORPORATION. WITH ME TODAY ARE LAWRENCE MASLAN,
DIRECTOR, OFFICE OF FINANCIAL OPERATIONS; HENRY ROSE, GENERAL
COUNSEL; GERALD E. COLE, JR., ASSISTANT EXECUTIVE DIRECTOR,
OFFICE OF POLICY AND PLANNING; AND JOHN HIRSCHMANN, CHIEF,
DIVISION OF FINANCIAL AND ACTUARIAL PROGRAM DEVELOPMENT.

I'M PLEASED TO BE ABLE TO TESTIFY BEFORE YOU TODAY AND I'M
LOOKING FORWARD TO WORKING CLOSELY WITH THIS SUBCOMMITTEE
AND THE CONGRESS TO ENSURE THE CONTINUATION OF A SOUND GUARANTEE
PROGRAM FOR THE RETIREMENT BENEFITS OF AMERICAN WORKERS.

PBGC'S CRITICAL NEEDS

I WOULD LIKE TO DISCUSS THE VERY CRITICAL NEEDS FACING
THE SINGLE EMPLOYER PENSION PLAN TERMINATION INSURANCE SYSTEM.

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ANNUAL PREMIUMS FROM PLAN SPONSORS PROVIDE THE FUNDS WHICH THE PENSION BENEFIT GUARANTY CORPORATION NEEDS TO PROTECT PARTICIPANTS AND BENEFICIARIES IN TERMINATED DEFINED BENEFIT PENSION PLANS AGAINST LOSS OF THEIR BASIC PENSION BENEFITS.

IN 1974, WHEN ERISA WAS PASSED, THE ANNUAL PREMIUM IMPOSED BY CONGRESS ON SINGLE EMPLOYER PLANS WAS \$1.00 PER PARTICIPANT. BY 1977, WHEN IT BECAME CLEAR THAT THE PREMIUM WAS NOT ADEQUATE TO COVER CLAIMS AGAINST THE SYSTEM, THE ANNUAL PREMIUM WAS INCREASED BY CONGRESS TO \$2.60 PER PARTICIPANT, EFFECTIVE JANUARY 1, 1978.

INCREASED CLAIM LEVEL

EVENTS SINCE THE 1977 PREMIUM INCREASE CLEARLY SUBSTANTIATE THE NEED FOR A FURTHER PREMIUM INCREASE AS SOON AS POSSIBLE.

THE AVERAGE CLAIM AGAINST THE CORPORATION FROM TERMINATING PLANS IS CURRENTLY OVER \$1 MILLION COMPARED TO JUST UNDER

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\$300,000 IN 1977. IN THE LAST 4 1/2 YEARS, NET CLAIMS FOR BENEFITS AGAINST THE CORPORATION HAVE INCREASED TO AN ANNUAL AVERAGE LEVEL OF \$62.3 MILLION FROM THE \$24.7 MILLION ANNUAL AVERAGE DURING THE FIRST 2 1/2 YEARS OF THE CORPORATION'S EXPERIENCE--UP ABOUT 2 1/2 TIMES. THIS 2 1/2-FOLD INCREASE IN NET CLAIMS ALONE FROM THE TIME OF OUR LAST PREMIUM INCREASE IS MORE THAN THE REQUESTED 2 1/3-FOLD INCREASE IN THE PREMIUM LEVEL.

THE AMOUNT OF CLAIMS INCURRED BY THE CORPORATION IS EQUAL TO THE PRESENT VALUE OF BASIC BENEFITS IN TERMINATED PLANS LESS THE SUM OF PLAN ASSETS TURNED OVER TO THE CORPORATION ON PLAN TERMINATION AND LESS ANY AMOUNTS RECOVERED BY THE CORPORATION UNDER THE EMPLOYER LIABILITY PROVISION.

THE PBGC'S DEFICIT

AS OF SEPTEMBER 30, 1981, THE CORPORATION'S DEFICIT WAS \$189 MILLION; THAT DEFICIT IS PROJECTED TO REACH \$236 MILLION

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BY DECEMBER 31, 1982. BY COMPARISON, THE DEFICIT WAS \$41 MILLION AT THE TIME WE LAST CAME TO CONGRESS FOR A PREMIUM INCREASE. THAT INCREASE WAS SPECIFICALLY INTENDED, AS STATED IN THE CORPORATION'S 1977 SUMMARY REPORT, TO BE ADEQUATE THROUGH 1981.

THE DEFICIT REPRESENTS THE AMOUNT BY WHICH THE PRESENT VALUE OF THE CORPORATION'S LIABILITY FOR BASIC BENEFITS EXCEEDS THE ASSETS OF THE CORPORATION. MORE SPECIFICALLY, IN DOLLAR TERMS, THE PRESENT VALUE OF ALL OF THE CORPORATION'S LIABILITIES WAS \$715 MILLION ON SEPTEMBER 30, 1981. ITS TOTAL ASSETS WERE \$526 MILLION. THE DIFFERENCE BETWEEN THOSE TWO FIGURES--\$189 MILLION--IS THE DEFICIT.

LOOKING TO THE FUTURE

LOOKING FORWARD INTO THE NEXT 5 YEARS, OUR BOARD OF DIRECTORS, AFTER CAREFUL CONSIDERATION, BELIEVES THAT THE GRANTING BY

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CONGRESS OF A PREMIUM INCREASE TO \$6.00 PER PARTICIPANT IN SINGLE EMPLOYER PLANS IS ESSENTIAL IF THE CORPORATION IS TO MAINTAIN THE INTEGRITY OF THE SYSTEM FOR THE 28 MILLION COVERED PARTICIPANTS AND TO FUND ITS OBLIGATIONS IN A FISCALLY PRUDENT MANNER.

THE CORPORATION'S PREMIUM STUDY, WHICH HAS BEEN PROVIDED TO YOU, FORECASTS THAT A PREMIUM INCREASE TO \$6.00 WOULD COVER PROJECTED NEW BENEFIT CLAIMS THROUGH THE END OF 1986, AND AMORTIZE, BY THE END OF 1987, THE \$236 MILLION DEFICIT THAT WE PROJECT WILL EXIST OF THE END OF CALENDAR FISCAL YEAR 1982. THE \$6.00 PREMIUM IS NOT DESIGNED TO COVER UNPRECEDENTEDLY LARGE BENEFIT CLAIMS WHICH MAY EVENTUATE, BUT ALLOWS FOR THE EXPECTATION THAT CLAIMS OF NORMAL SIZE WILL INCREASE AND WILL PERMIT THE CORPORATION TO RETIRE ITS DEFICIT OVER A FIVE-YEAR PERIOD.

I THINK IT IS USEFUL TO SET FORTH INITIALLY HOW THE \$6.00 PREMIUM WILL BE ALLOCATED TO THE CORPORATION'S CLAIMS, DEFICIT RETIREMENT AND ADMINISTRATIVE COSTS.

PORTION OF PREMIUM TO PAY CLAIMS

SLIGHTLY OVER HALF THE PREMIUM IS DEVOTED TO MEETING FUTURE CLAIMS. AS NOTED EARLIER, THE CORPORATION'S AVERAGE ANNUAL BENEFIT CLAIMS GREW FROM \$24.7 MILLION FOR THE PERIOD FROM THE INCEPTION OF THE CORPORATION THROUGH MARCH 1977, TO \$62.3 MILLION FOR THE MOST RECENT 4 1/2 YEARS THROUGH 1981. BASED ON SUCH PAST EXPERIENCE AND OTHER FACTORS, WE HAVE CONCLUDED THAT IT WOULD BE REASONABLE AND PRUDENT TO ASSUME THAT THIS UPWARD TREND WILL CONTINUE.

ON THE BASIS OF OUR CLAIMS EXPERIENCE, WE EXPECT THAT CLAIMS WILL INCREASE BY ABOUT \$8 MILLION PER YEAR IN THE FUTURE. THIS UPWARD TREND IN CLAIMS AGAINST THE CORPORATION REFLECTS

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A NUMBER OF FACTORS, INCLUDING AN INCREASE IN THE AMOUNT OF PLAN BENEFITS TO PARTICIPANTS AND AN INCREASE IN THE NUMBER OF PARTICIPANTS IN PLANS THAT HAVE TERMINATED. WHILE BENEFIT CLAIMS HAVE BEEN INCREASING, ASSETS OF TERMINATED PLANS TAKEN OVER BY THE CORPORATION HAVE REMAINED A RELATIVELY CONSTANT PERCENTAGE OF TOTAL GUARANTEED BENEFIT CLAIMS. THE RESULT IS THAT THE AMOUNT OF PLAN UNDERFUNDING PER PARTICIPANT HAS INCREASED. WE HAVE NO DOUBT THAT BENEFIT CLAIMS AGAINST THE CORPORATION WILL CONTINUE TO RISE. INCREASES IN BENEFIT CLAIMS ARE CONSISTENT IN CONCEPT WITH OTHER COMPONENTS OF THE TOTAL COMPENSATION PACKAGE, SUCH AS WAGES, WELFARE BENEFITS, AND THE LIKE, ALL OF WHICH HAVE BEEN INCREASING IN DOLLAR TERMS TO MAINTAIN COMPENSATION LEVELS.

WHEN THE \$8 MILLION INCREASE PER YEAR IS PROJECTED INTO THE FUTURE, IT PRODUCES AN AVERAGE ANNUAL LEVEL OF CLAIMS IN THE YEARS 1983-1986, OF \$96.8 MILLION. WHEN THIS SUM IS

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DIVIDED BY AN ANTICIPATED AVERAGE OF 32.1 MILLION PARTICIPANTS IN SINGLE EMPLOYER DEFINED BENEFIT PLANS IN THOSE YEARS (UP FROM 28.3 MILLION AT PRESENT), THE RESULTING REQUIRED PREMIUM TO MEET FUTURE CLAIMS IS \$3.02.

PORTION OF THE PREMIUM TO RETIRE THE DEFICIT

TO THIS FIGURE THERE MUST BE ADDED, IF THE CORPORATION IS TO RETIRE THE PROJECTED 1982 YEAR-END DEFICIT OF \$236 MILLION OVER FIVE YEARS, AN ADDITIONAL ANNUAL PREMIUM OF \$1.95 PER PARTICIPANT.

PORTION OF THE PREMIUM TO PAY ADMINISTRATIVE EXPENSES

ADMINISTRATIVE EXPENSES HAVE BEEN PROJECTED ON THE BASIS OF THE 1983 BUDGET, INCREASED BY PROJECTED INCREASES IN THE CONSUMER PRICE INDEX THROUGH 1986. THE RESULTING REQUIRED ANNUAL PREMIUM FIGURE TO COVER SUCH COSTS IS \$.97 PER PARTICIPANT.

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THE TOTAL OF THESE COST COMPONENTS IS \$5.94, WHICH WE HAVE ROUNDED TO \$6.00. THAT PREMIUM, TO PUT IT IN CONTEXT, AMOUNTS TO LESS THAN 1% OF ANNUAL PENSION COSTS, ONLY A TENTH OF A PERCENT OF ALL EMPLOYEE BENEFITS, THREE-TENTHS OF A CENT FOR EVERY HOUR WORKED, AND JUST .04% OF ANNUAL PAYROLL COSTS.

THE CORPORATION'S GOAL

THE PREMIUM INCREASE, IF THE ASSUMPTIONS MADE ARE ACTUALLY REALIZED, WOULD PLACE THE CORPORATION'S INSURANCE PROGRAM FOR SINGLE EMPLOYER PLANS ON A FUNDING BASIS WHICH WOULD BE APPROPRIATE UNDER PRUDENT INSURANCE CONCEPTS. AT THE END OF FISCAL 1981, PBGC WAS RESPONSIBLE FOR THE GUARANTEED BENEFITS OF 80,000 PERSONS--39,000 RETIRED, AND 41,000 WITH DEFERRED VESTED BENEFITS. PAYMENTS ARE CURRENTLY BEING MADE UNDER TERMINATED INSUFFICIENT SINGLE EMPLOYER PLANS TO SLIGHTLY OVER 39,000 PEOPLE, IN AN AMOUNT WHICH TOTALLED \$57 MILLION IN FISCAL YEAR 1981 AND MAY APPROXIMATE \$75 MILLION IN FISCAL

YEAR 1982. I BELIEVE THAT THE RESPONSIBLE WAY IN WHICH TO RUN THE CORPORATION IS TO ATTAIN, AS RAPIDLY AS CAN REASONABLY BE EXPECTED, A CURRENT FUNDING STATUS FOR THE CORPORATION. THAT OBJECTIVE TRANSLATES INTO A FINANCIAL CONDITION IN WHICH THE CORPORATION WILL HAVE ON HAND, AT ANY POINT IN TIME, AN AMOUNT OF ASSETS WHICH, TOGETHER WITH THE EXPECTED RETURN ON THEIR INVESTMENT, WILL BE SUFFICIENT TO FUND ALL LIABILITIES THAT THEN EXIST. IN THIS WAY, PREMIUM PAYERS IN THE FUTURE WILL NOT BE REQUIRED TO ASSUME WHAT MIGHT BE TERMED AN UNFAIR SHARE OF THE BURDEN OF FINANCING THE COST OF PAST TERMINATIONS OF PLANS. OUR APPROACH SHOULD LESSEN THE NEED FOR A PREMIUM INCREASE IN THE FUTURE.

IN SHORT, ASSUMING THAT OUR PROJECTED FUTURE CLAIMS FOR BENEFITS, THE CORPORATION'S ADMINISTRATIVE COSTS, ITS RETURN ON INVESTMENTS, AND ITS MORTALITY ASSUMPTIONS, TURN OUT TO BE AS PROJECTED, THE \$6.00 PREMIUM WILL RETIRE THE DEFICIT

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AT THE END OF FIVE YEARS AND BRING THE CORPORATION TO A CURRENTLY FUNDED BASIS.

THE CORPORATION HAS CONSISTENTLY SET AS ITS GOAL ACHIEVING LEVELS OF INCOME ADEQUATE TO FUND THE LIABILITIES IT INCURS ON A CURRENT BASIS AS THEY ACCRUE. THE CORPORATION BELIEVES THAT UNDER THE CIRCUMSTANCES FACING IT, FIVE YEARS IS A REASONABLE PERIOD IN WHICH TO SEEK TO ELIMINATE ITS DEFICIT. IF, AS EVENTS UNFOLD, LARGER THAN PROJECTED CLAIMS WERE INCURRED BY THE CORPORATION, THE DEFICIT COULD INCREASE DURING THE FIVE YEAR PERIOD, RATHER THAN DECREASE. LARGER THAN PROJECTED CLAIMS COULD BE CAUSED BY A VARIETY OF FACTORS:

- * AN INCREASING LEVEL OF BANKRUPTCIES;
- * THE GROWING AWARENESS BY SOPHISTICATED PLAN SPONSORS THAT THEY CAN ATTEMPT TO TRANSFER MUCH OF THEIR

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UNFUNDED VESTED LIABILITIES UNDER EXISTING LAW TO

THE CORPORATION BY CAREFUL PLANNING;

- * THE ATTRACTION FOR PLAN SPONSORS TO TERMINATE OVERFUNDED DEFINED BENEFIT PENSION PLANS AND RECOUP EXCESS PLAN ASSETS FOR GENERAL CORPORATE PURPOSES, WEAKENING THE CORPORATION'S PREMIUM BASE OVER TIME;
- * THE RELATIVELY LOW RATES OF FUNDING THE PRESENTLY EXISTING UNFUNDED VESTED LIABILITIES IN SINGLE EMPLOYER PLANS;
- * THE STATUTORY PROVISIONS WHICH, WITH INTERNAL REVENUE SERVICE APPROVAL, PERMIT PLAN SPONSORS TO RECEIVE WAIVERS OF THE MINIMUM FUNDING STANDARDS, IN HARDSHIP CASES, UNDER CERTAIN CONDITIONS;
- * THE GROWING TENDENCY OF PLAN SPONSORS TO RAISE THE INTEREST RATES THEY USE FOR CALCULATING REQUIRED PLAN RESERVES, WHICH RESULTS IN REDUCING A PLAN SPONSOR'S REQUIRED ANNUAL CONTRIBUTION, AND EVENTUALLY

CREATES LARGER UNFUNDED VESTED LIABILITIES WHERE
THE HIGHER ASSUMED INTEREST RATES ARE NOT, IN FACT,
REALIZED.

IN ADDITION, AN INSURER SUCH AS THE CORPORATION MUST
KEEP IN MIND THAT IF LOWER THAN EXPECTED INVESTMENT RATES
WERE ACHIEVED, UNEXPECTED MORTALITY LOSSES WERE TO EMERGE,
OR ADMINISTRATIVE EXPENSES WERE TO INCREASE ABOVE PROJECTED
LEVELS, THE DEFICIT COULD ALSO INCREASE DURING THE FIVE-YEAR
PERIOD, RATHER THAN DECREASE. UNDER SUCH CONDITIONS, THE
CORPORATION WOULD HAVE TO ADDRESS WHETHER CONGRESS SHOULD
BE REQUESTED TO AUTHORIZE A FURTHER PREMIUM INCREASE. IN
CONTRAST, IF THE ACTUAL CORPORATION'S EXPERIENCE TURNED OUT
TO BE MORE FAVORABLE THAN PROJECTED--AN UNLIKELY RESULT DURING
THE NEXT FIVE YEARS UNLESS MANY CHANGES ARE MADE IN THE LAW--THE
POSSIBILITY OF REDUCING THE PREMIUM COULD BE ADDRESSED.

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IN SHORT, WE BELIEVE THAT THE SINGLE EMPLOYER INSURANCE PROGRAM SHOULD BE FINANCED SO THAT ACHIEVEMENT OF THE CORPORATION'S GOAL OF "CURRENT FUNDING" WITHIN A FIVE-YEAR PERIOD IS MADE POSSIBLE. OUR OVERALL GOAL IS TO MAINTAIN A SOUND SYSTEM OF INSURANCE, AS MANDATED BY CONGRESS, SO THAT THE INSURANCE GUARANTEE EXPECTATIONS OF SOME 80,000 PARTICIPANTS OF ALREADY TERMINATED INSUFFICIENT PLANS WILL BE PROPERLY PROTECTED, AND SO THAT APPROPRIATE PROTECTION IS PROVIDED TO THE 28 MILLION PARTICIPANTS, IN ONGOING COVERED PLANS. THE WAY TO ENABLE THE CORPORATION TO ACHIEVE THIS GOAL IS TO PROVIDE THE CORPORATION WITH SUFFICIENT PREMIUMS SO THAT ITS ASSETS WILL REACH A LEVEL WHERE THEY WILL BE EQUAL TO THE PRESENT VALUE OF THE BENEFITS THAT ARE PAYABLE TO PARTICIPANTS FOR THE REMAINDER OF THEIR LIVES.

TOGETHER WITH THE PREMIUM INCREASE, WHICH CAN ONLY COME FROM CONGRESS, THE CORPORATION, ON ITS PART, WILL EXERT EVERY

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EFFORT TO ADDRESS EXISTING AND POTENTIAL PROBLEMS AS QUICKLY AND AS THOROUGHLY AS POSSIBLE. I HAVE SET, AS ONE OF MY HIGHEST PRIORITIES, A CAREFUL STUDY OF THE MANY ISSUES THAT HAVE BEEN PRESENTED TO ME BY KNOWLEDGEABLE REPRESENTATIVES OF MANY INTERESTS IN THE SHORT SPACE OF TIME THAT I HAVE BEEN EXECUTIVE DIRECTOR.

TIME IS OF THE ESSENCE

WE RESPECTFULLY OBSERVE THAT TIME IS OF THE ESSENCE IN SETTING THE EFFECTIVE DATE OF THE PREMIUM INCREASE. THE CORPORATION IS ASKING CONGRESS FOR ACTION ON THE PREMIUM LEVEL DURING THIS SESSION OF CONGRESS SO THAT IT WILL BE EFFECTIVE JANUARY 1, 1983. I WOULD NOTE, IN THIS CONNECTION, THAT TITLE IV REQUIRES THAT AN INCREASE, PROPOSED BY THE CORPORATION, BE ADOPTED AT LEAST 30 DAYS BEFORE THE INCREASED PREMIUM RATE CAN BE PUT INTO EFFECT. THE LONGER THE DELAY IN INCREASING THE PREMIUM, THE GREATER WILL BE THE INSURANCE COST AND THE RESULTING PREMIUM THAT WILL HAVE TO BE PAID IN THE FUTURE, SINCE THE CORPORATION'S

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DEFICIT WILL BE INCREASING DURING THE INTERIM PERIOD. FOR EXAMPLE, IF THE EFFECTIVE DATE OF THE PREMIUM INCREASE WERE TO BE DELAYED ONE YEAR FROM THE REQUESTED DATE, AN ANNUAL PREMIUM OF \$6.79 PER PARTICIPANT WOULD BE REQUIRED TO ACHIEVE THE SAME RESULT AS A PROMPT INCREASE TO A \$6 PREMIUM. FURTHERMORE, BECAUSE 70% OF THE CORPORATION'S PREMIUM INCOME IS DERIVED FROM PLANS WITH PREMIUM YEARS BEGINNING IN JANUARY, A DELAY OF ONLY ONE MONTH IN THE EFFECTIVE DATE TO FEBRUARY 1, 1983 WOULD STILL INCREASE THE REQUIRED PREMIUM LEVEL TO \$6.56.

NO ALLOWANCE MADE FOR ANY LARGE CLAIMS
OF UNPRECEDENTED SIZE

ONE ADDITIONAL POINT SHOULD BE MADE. IN MAKING THESE PROJECTIONS, NO ALLOWANCE HAS BEEN MADE FOR THE CREATION OF A RESERVE FOR ANY LARGE CLAIMS OF UNPRECEDENTED SIZE WHICH MAY DEVELOP FROM THE TERMINATION OF A RELATIVELY SMALL NUMBER OF VERY LARGE PLANS. TO SET ASIDE A RESERVE OF ONE BILLION DOLLARS FOR SUCH EVENTUALITIES OVER THE NEXT FOUR YEARS, THE

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PREMIUM WOULD HAVE TO BE INCREASED TO \$12.64 PER PARTICIPANT EFFECTIVE JANUARY 1, 1983. HOWEVER, AS THE MATERIALS SUPPORTING OUR REQUESTED PREMIUM INCREASE EXPLAIN MORE FULLY, AT THIS TIME THE CORPORATION HAS CHOSEN NOT TO ASK CONGRESS FOR SUCH A PREMIUM LEVEL IN ADVANCE. IF SUCH LARGE CLAIMS ACTUALLY OCCUR, PLAN ASSETS ON HAND AT TERMINATION WILL PROBABLY BE ADEQUATE TO PAY GUARANTEED BENEFITS FOR SOME YEARS, PROVIDING ADEQUATE TIME TO SEEK ANY NECESSARY PREMIUM INCREASE OR MAKE OTHER RECOMMENDATIONS TO CONGRESS.

PENDING LEGISLATION

I'D LIKE TO TURN NOW TO THE LEGISLATIVE PROPOSALS RELATING TO THE SINGLE EMPLOYER PROGRAM, PENDING BEFORE THIS SUBCOMMITTEE, AND IN SO DOING, ANTICIPATE A QUESTION THAT WE HAVE CONSIDERED AT THE CORPORATION--THE EFFECT OF SUCH LEGISLATION ON THE AMOUNT OF THE PREMIUM. THE PREMIUM INCREASE IS FOUNDED ON AN ASSUMPTION THAT OUR EXPERIENCE TO DATE WILL NOT MATERIALLY

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CHANGE. WITHOUT LEGISLATION, THAT ASSUMPTION WILL NOT HOLD; LOGIC DICTATES THAT ABUSIVE CLAIMS WILL INCREASE. IT IS A DECIDEDLY ATTRACTIVE OPTION TO TERMINATE ONE'S PENSION PLAN WHERE THE PLAN'S UNFUNDED LIABILITY EXCEEDS THE STATUTORY LIMIT ON EMPLOYER LIABILITY TO THE PBGC, CURRENTLY 30% OF NET WORTH. SIMILARLY, THE SALE OF A BUSINESS WITH LARGE UNFUNDED PENSION LIABILITIES TO A WEAK BUYER ALLOWS THE SELLER TO INSULATE ITSELF FROM EMPLOYER LIABILITY--AN ECONOMICALLY TEMPTING COURSE. THIS TACTIC EFFECTIVELY DASHES ANY CHANCES OF PBGC RECOVERY EITHER FROM THE SELLER OR FROM THE WEAK BUYER. EMPLOYERS IN RECENT YEARS HAVE BECOME INCREASINGLY AWARE OF THESE SOFT SPOTS IN ERISA--AND WIDESPREAD KNOWLEDGE CAME JUST AS ECONOMIC CONDITIONS ENCOURAGED EMPLOYERS TO SEEK OPERATING ECONOMIES FROM DIFFERENT SOURCES. IF THESE CLAIMS AGAINST THE SYSTEM ARE NOT LEGISLATIVELY OUTLAWED, THE PREMIUM WE SEEK TODAY WILL NOT BE ENOUGH.

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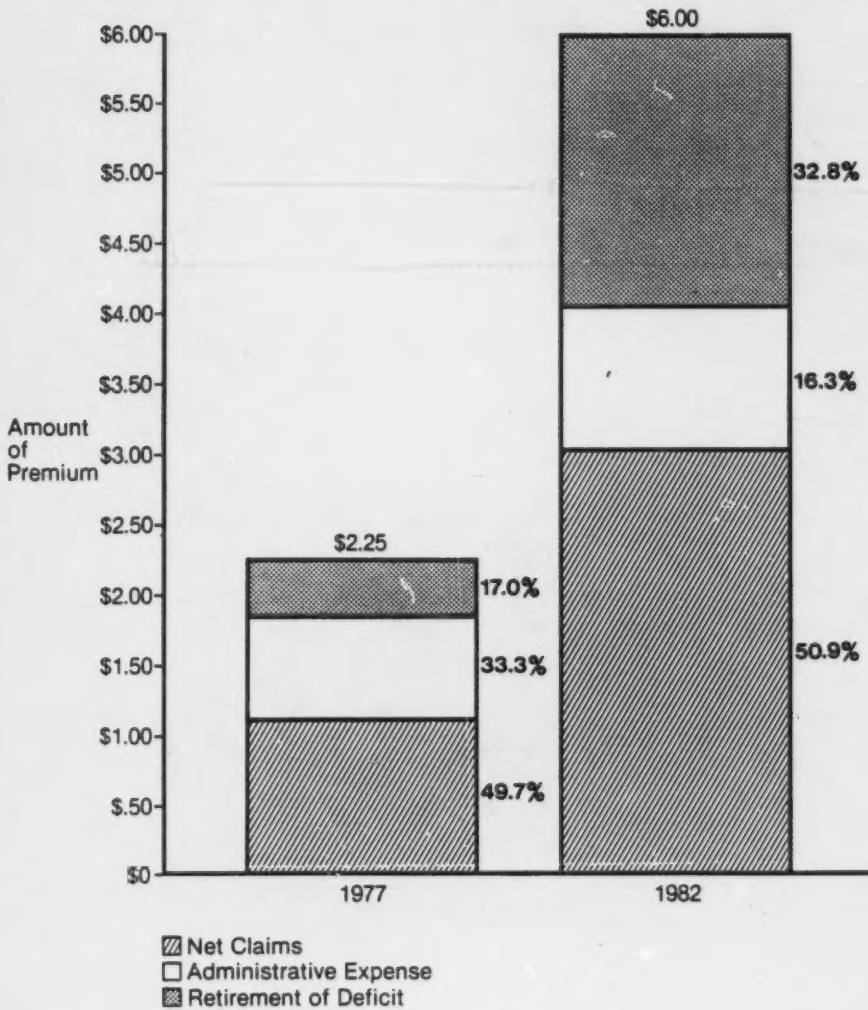
THUS, THE NEED FOR PROMPT ACTION SO THAT WE MAY BEGIN COLLECTING PREMIUM REVENUES MATCHED TO PAST EXPERIENCE IS STRONG. IT IS EQUALLY CLEAR THAT LEGISLATIVE REFORM IN THE SINGLE EMPLOYER PROGRAM IS ESSENTIAL TO PROTECT THE SYSTEM AT THE PREMIUM LEVEL WE HAVE PROPOSED. TITLE VI OF S.1541 GOES A LONG WAY IN ADDRESSING THE PROBLEMS WE HAVE IDENTIFIED IN THE SYSTEM.

WILLIAM NISKANEN, OF THE COUNCIL OF ECONOMIC ADVISERS, TESTIFIED BEFORE YOU SEVERAL MONTHS AGO, AND HE MADE CLEAR THAT CHANGING THE INSURABLE EVENT, ADDING A TRANSFER RULE, AND GIVING PBGC GENERAL CREDITOR STATUS ARE ESSENTIAL TO ANY ADEQUATE REFORM OF THE SINGLE EMPLOYER PLAN PROGRAM. WE ARE STILL SOLIDLY BEHIND THAT RECOMMENDATION.

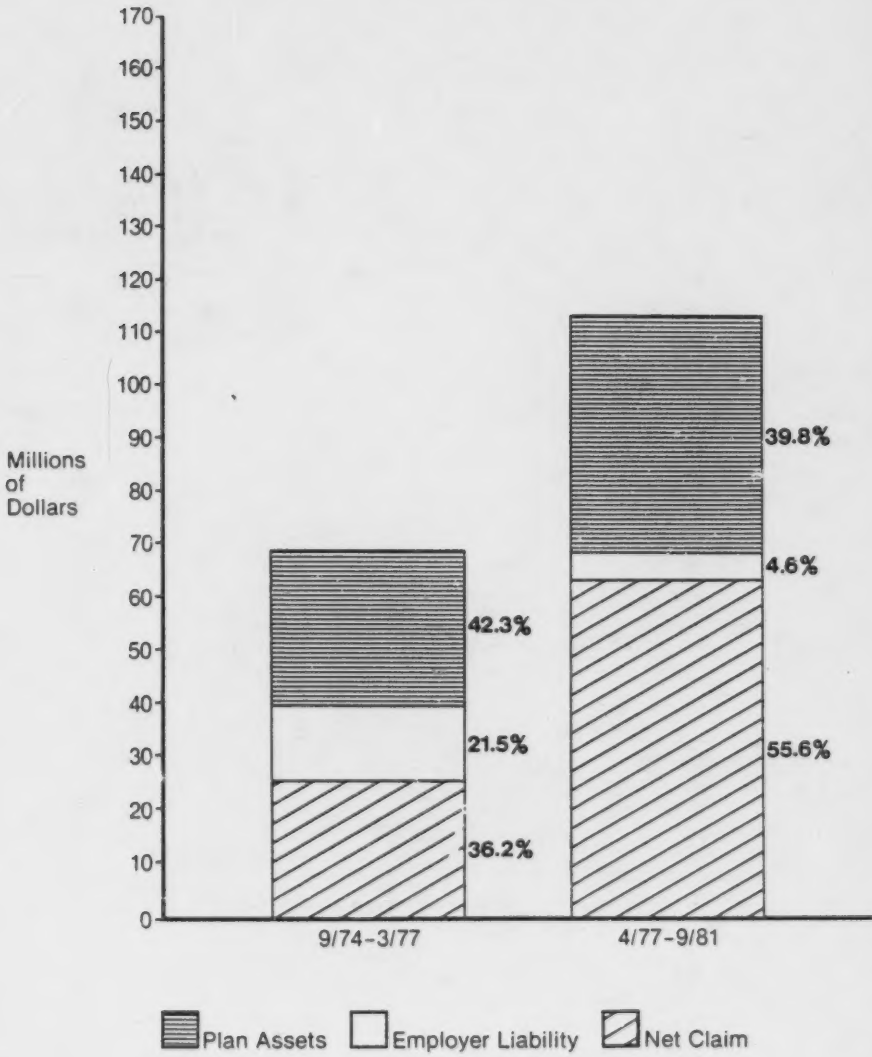
IN CONCLUSION, WE ASK THAT YOU CONSIDER AND APPROVE OUR PREMIUM REQUEST AS RAPIDLY AS POSSIBLE. I THANK YOU FOR YOUR TIME, AND WE WOULD BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

BEST COPY AVAILABLE

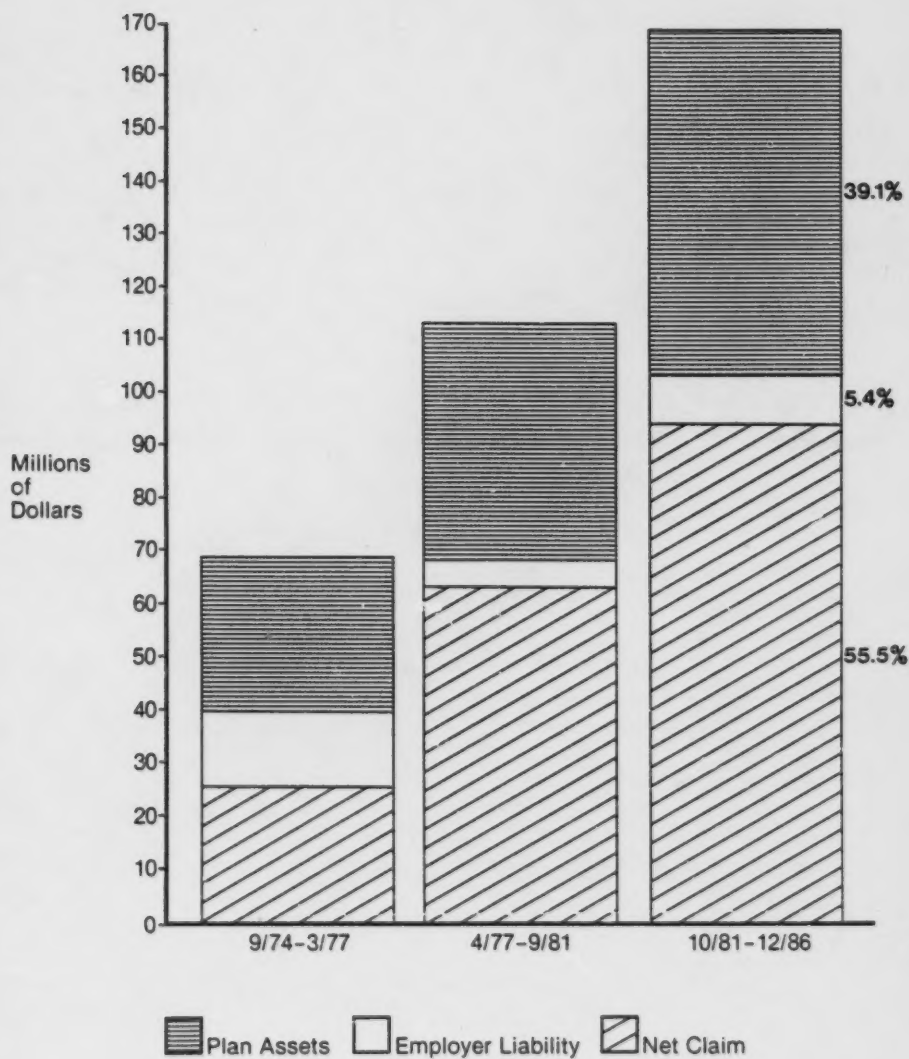
Comparison of Cost Components of the PBGC Premium Requests, 1977 and 1982



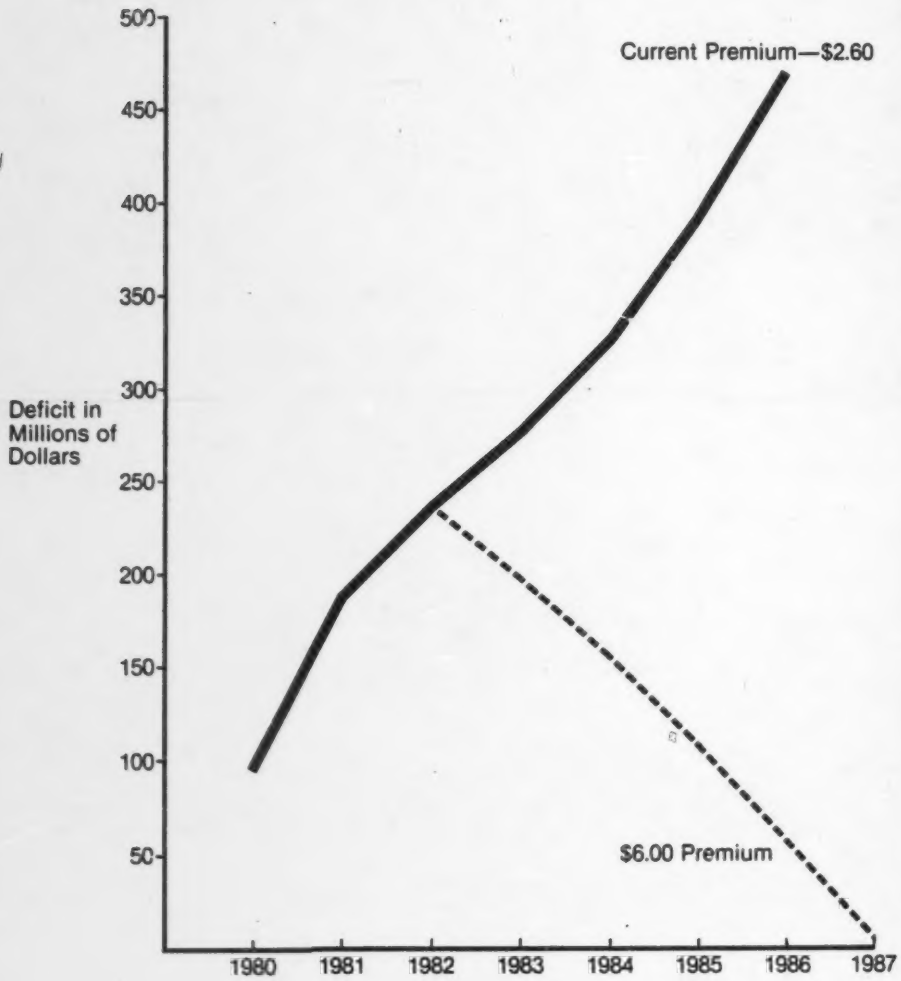
Average Annual Claims



Average Annual Claims



Impact of Premium Increase on Deficit



Senator NICKLES. I appreciate that very much, Mr. Jones.

In listening to your comments and just really having the chance to read through them last evening, concern came to me from the fact that I saw so much time and emphasis built in supporting the need for the rate increase and little talk for the need of reform.

As I indicated in my opening remarks, it is very much my belief that until we get to the actual reform measures, we are not going to be able to solve our problem. I notice the chart showed a 3-year projection, or three groups of years of what it would be, but basically we see a very rapidly rising payout. Therefore, we are going to have to see very rapidly rising premium increases unless we see—I think some very, very significant reforms.

Right now, we have a way to go. I think there is an effort and a very good possibility that we may be able to come up with some consensus changes that can get through this Congress. It is my firm belief that I will oppose the premium increase until we get some of these reforms. Basically, all we would be doing is treating some of the symptoms and not going to the real root of the problem.

I would take issue from the standpoint of employers across the country that \$3.60 may not seem too significant if their payroll averages \$9 an hour or, whatever it may be. But you have a lot of people right now who are still weighing the decisions of whether or not they want to continue in defined benefit plans. They saw this liability in 1974 and kept on when they saw the premium was \$1 or maybe it was increased to \$2.60; but when they see the premium now going to \$6, they may be assessing their situation and move over to the defined benefit plan or IRA plan.

With that thought, I would suspect or question the numbers that you use as far as the increasing number of participants. I think there would be some shock waves with the premium going from \$2.60 to \$6. If we have one or two of these larger failures happen, and we need to come back in a short period of time to keep the system, I think you will see a rapid erosion in your base; that is, let us look at a smaller employer. I came from a plan that had 100 participants, \$1, and 100.

Now, you are talking about \$6 and 600. Again these people are weighing these decisions on what type of compensation shall I have. I think more and more often they are going to be looking at the defined benefit plans when they are liable for other people's benefits. I think it is extremely important that we eliminate a lot of the abuses that are now available and legal in the system, allowing people to dump their liabilities on the rest of the employers.

I welcome your support for that, and I would like to see it on a very strong cooperative way where we are able to make some of these reforms, and do it this year.

The premium rate increase is going to accelerate the awareness of the issue in Congress, which I think may be good because there are enormous liabilities that are pending. Was my figure estimate on Braniff close to correct?

Mr. JONES. Yes, sir. We do not have actual figures. Again that depends on asset valuations and a whole host of individual factors. But our best estimate on the basis of rather considerable checking is in the area of the figure that you are talking about.

Senator NICKLES. \$70 million?

Mr. JONES. It could be somewhat lower, but that certainly is a possibility. It might be as low as \$50 million, but I think that \$70 million, if we had the exact figures today, that could be where it would come out.

Senator NICKLES. Have there been some discussions as far as takeover, somebody taking over that plan to where there would not be a termination event coming about where PBGC—or is PBGC automatically going to be involved in the case and assume that?

Mr. JONES. We have not—to answer your question as best I can, we have not yet received any notice of intent to terminate by Braniff. We have received, within the last day or two, a notice of a reportable event; namely, the bankruptcy. We had been looking at these figures and the figures of many other companies. We are directly involved now in assessing on a realistic basis what we may be facing in terms of other companies. We have done that preliminarily with respect to Braniff, and we are in contact with the company.

However, there is nothing I can say at this time. It is very much in Braniff's hands at this point.

Senator NICKLES. Well, we would appreciate it if you would keep our committee advised, too, of those events.

Let me ask you for some information. I know you gave me a wealth of information. I have not had time to digest it all.

But for this record, for the committee's record, I would appreciate it if you and your staff could compile some information on an annualized basis from 1974 forward on the number of premiums, the number of payouts, the amount of assets, the earnings of the assets, the amount of liabilities incurred that year and the accumulated liabilities so that we could have one basic 8½ by 11 to show us how we progress.

You know, when we had a \$1 premium and the amounts they received—the amounts they paid out, the amount of unfunded liabilities paid out, and be able to run that through—the charts were helpful in grouping some of the years. And I realize that one year you may have a bigger plan. I would like to have that, and I would like to have it into the record, I think, to substantiate, one, in my opinion, the ever increasing, growing liabilities that are occurring. If you could compile that, we will keep the record open.

Mr. JONES. We would be happy to. We believe we can do it easily because in the rather voluminous appendixes there are charts of that kind, and we would be happy to pull out a summary, if you will, and get it into one along the lines that you are talking about.

Senator NICKLES. We are not going to enter the entire volume, of course, in the hearing record, but I would like for that statement to be entered into the hearing record which our colleagues, if they want to research, could read.

Mr. JONES. We would like in that connection to enter into the record a part of the appendices. There is one introductory management portion which is rather a more detailed summary of a lot more of the specific facts, and if you would consider entering that into the record along with the testimony, that would be appreciated.

Senator NICKLES. We will take a look at it.

I am trying to keep the record not too voluminous where if they want to get to the issues that they can. Administratively you set about \$6. One would be administrative expense. What is the administrative expense now for PBGC?

Mr. JONES. Somewhat less than \$30 million.

Mr. MASLAN. About \$25 million.

Senator NICKLES. Conversely if, on this same chart, if you could show us the administrative costs of PBGC for the years, that would also be appreciated.

[The statement and chart referred to follows:]

PENSION BENEFIT GUARANTY
CORPORATION

PREMIUM REQUIREMENTS
FOR THE SINGLE-EMPLOYER BASIC BENEFITS
INSURANCE PROGRAM
May 1982

I. MANAGEMENT SUMMARY

The Pension Benefit Guaranty Corporation (PBGC or the Corporation) has received formal authorization from its Board of Directors to request Congressional approval of an increase in the premium for the single-employer basic benefits program. The Corporation is requesting that the premium be raised to \$6.00 per participant effective January 1, 1983. This document summarizes the background and basis for the Corporation's request.

The annual premium for the single-employer program was originally \$1.00 per participant. Effective January 1, 1978, it was increased to \$2.60 per participant. The premium is used to: 1) finance claims from terminating insufficient pension plans, 2) pay administrative expenses of the Corporation, and 3) amortize the Corporation's current deficit.

Events since the last premium increase indicate that a further increase is needed. The average claim per terminating plan is currently \$1,022,000 compared to \$297,000 when the last increase was requested. Total annual claims since the time of the last study have averaged \$62.3 million; previously they averaged \$24.7 million.

As a result, even with the benefit of the 1978 premium increase from \$1.00 to \$2.60 per participant, the Corporation's deficit rose from \$41.0 million as of September 30, 1976 to \$188.8 million as of September 30, 1981. Without a premium increase, the deficit is expected to increase to about \$470 million by the end of 1986. PBGC has over \$526 million in single-employer fund assets, of which \$348 million represents liquid investments that are immediately available to the PBGC as trustee to pay benefits. This amount is still increasing.

PBGC's benefit payments now amount to \$57 million annually. Thus, PBGC's ability to pay benefits is not now in jeopardy on a pay-as-you-go basis. Based on past experience, as pension plans terminate in the future with insufficient assets to cover vested guaranteed benefits, such plans can be reasonably expected to bring with them enough assets to cover benefits for at least a few years following termination. However, the plans' benefit liabilities increase the Corporation's long-term unfunded liability even

further and create the basis for future shortfalls unless the premium is increased. The occurrence of the termination of a plan of a large company with large unfunded vested guaranteed benefits would necessarily exacerbate the situation.

The increase in PBGC's single employer average annual claims grew from \$24.7 million through March, 1977 to \$62.3 million in the most recent 4 1/2 years. This increase, when analyzed statistically, indicates an annual increase in the level of claims of just over \$8 million. Based upon this analysis of past experience and other factors, the PBGC has concluded that it would be most unrealistic and imprudent to assume this trend will not continue. The expected increase in benefit levels alone should produce most if not all of this kind of growth. Thus, very little if any leeway is built in for termination of plans with more participants than those which have terminated to date and which would undoubtedly cause larger claims.

When this \$8 million increase is projected to the years 1983-86, it produces an expected annual level of claims of \$96.8 million. When this sum is divided by the 32.1 million participants (up from 28.3 million participants at present) the resulting required premium to meet future claims is \$3.02 . This figure leaves no provision for retiring the 1981 fiscal year end deficit of \$188.8 million, which the Corporation expects will increase to

\$236.3 million by 1982 calendar year end. To retire this deficit of \$236.3 million over five years requires an additional premium of \$1.95.

Finally, administrative expenses are projected on the basis of approved OMB figures for 1982 and 1983, and holding them constant in real terms for 1984 through 1986. The resulting premium figure is \$0.97 per participant.

The total of these cost components is \$5.94 which has been rounded to \$6.00.

The requested premium increase would place the insurance program for single-employer plans on a funding basis which would be appropriate under prudent insurance concepts. If a typical insurance company were faced with an existing deficit at the end of a year, every effort would be made to increase the premium as much as competitively possible to eliminate the deficit as soon as possible. The PBGC feels under the circumstances facing it, that five years is a reasonable period to eliminate its deficit. Events such as larger than projected claims, unfavorable investment experience, mortality losses and increased administrative expenses over projected levels could result in the deficit increasing even more during the five year period. In such a case the PBGC would

need to address whether a further premium increase should be recommended to Congress. Of course, if the opposite occurred, the possibility of reducing the premium could be addressed.

In short, the single-employer program should be financed so that "current funding" can be expected to be achieved within a five year period. The way to do this is to provide the PBGC with sufficient premiums so that PBGC's assets will be equal to the present value of the liabilities that are payable to participants for the remainder of their lives.

The premium increase being requested will not do a number of things. In particular, it will not create a reserve or surplus for extraordinarily large claims, if any occur. Available data indicates that there is about \$20 billion in unfunded vested liabilities in pension plans insured by the PBGC. Approximately \$3 billion of this underfunding is in plans whose sponsors are experiencing severe business hardship. Therefore, if these plans were terminated, the level of claims against the PBGC could increase materially in the future. However, given the current interest rate assumption being used by these plans, the net claims from any of these plan sponsors are probably less than the reported unfunded vested liability. Nevertheless, such values indicate that the magnitude of potential net claims is significant.

Since there is no reliable method for determining the appropriate amount of a reserve for extraordinarily large claims, no additional premium for such claims is now being requested. Moreover, the need for such a reserve is diminished by the following factors: 1) PBGC's current liquidity on a pure cash-flow basis for the immediate future; 2) its authority to borrow up to \$100 million from the U.S. Treasury; and 3) the likelihood that any large terminating plan that the PBGC would receive in the future will have enough assets to pay benefits for a few years.

While the Corporation does not believe a reserve is necessary, the potential for future large claims means that the existing deficit should be retired as quickly as possible. For this reason, the single-employer deficit should be funded over five years. The PBGC program will then be funded on a more financially prudent and currently-funded basis. This will result in plans now in existence paying for claims which have been and are now being incurred. Such a result has an essential element of fairness. Plans which may eventually result in claims against the PBGC will be paying for the protection they are receiving rather than shifting the burden to future generations of plans.

In addition to the sensitivity of the premium to the absence or presence of a few large claims, PBGC's premium request also assumes that the number of "abusive claims" in the future will not materially increase. The "abusive claims" include two types of situations where it is possible for an on-going employer to profit by shifting responsibility for funding a pension plan onto the PBGC insurance system. The first situation involves the sale or spinoff of a weak subsidiary with an underfunded pension plan. As part of the sale, the "strong seller" either partitions or transfers the pension plan and transfers all or part of the unfunded liability to the "weak buyer". If the plan subsequently terminates, the "weak buyer" is not fully liable to PBGC for the underfunding due to the 30% of net worth limitation on employer liability. The second situation involves the termination by an on-going sponsor of a pension plan(s) whose underfunding substantially exceeds the employer's statutory liability to the PBGC for 30% of its net worth. Current pending legislation, S. 1541, H.R. 4330 (the "Nickles-Erlenborn Bill"), contains provisions that would eliminate the possibility for these "abusive claims" occurring in the future.

To date, PBGC estimates that "abusive claims" have represented about 20% of the Corporation's claims experience. Since the recommended premium rate of \$6.00 assumes a continuation of past experience, that recommended amount could be reduced to about \$5.40 if corrective legislation were adopted. More significantly, in the absence of legislation, the economic incentive for causing "abusive claims" would remain. Given the potential for abuse, PBGC's claims could increase materially. The premium needed could be much greater than \$10.00 since:

- o The PBGC's exposure has been estimated to be about \$20 billion in unfunded vested liabilities. One percent of these unfunded vested liabilities could well be associated with distressed divisions or subsidiaries. If they were subsequently sold by a "strong seller" to a "weak buyer", the Corporation could have to subsequently absorb an additional \$200 million in claims when the buyers terminated their plans.
- o The PBGC identified 57 firms with an economic incentive to terminate their plans. These are plans whose unfunded vested liability exceeds 30% of the market value of their sponsor's net worth. The total unfunded vested liabilities for these firms is \$8.8 billion.

The PBGC recommends increasing the premium to \$6.00 for the following reasons:

- o PBGC's claims have been growing steadily.
- o Such a premium reduces the need for PBGC to increase the premium to much higher levels in the future.
- o If future claims are lower than forecast, the deficit will be amortized more rapidly.
- o The recommended premium will be less than 1% of annual pension costs, about 1/10 of 1% of fringe benefits, and about 4/100 of 1% of annual payroll costs.

The majority (greater than 70%) of plan years begin on January 1. Therefore, approval of the premium increase during this session of Congress is being requested. The premium increase could then be made applicable to plan years beginning on or after January 1, 1983.

The balance of the main body of this report discusses the basis of the Corporation's request in more detail. Technical details are contained in the Appendices.

II. INTRODUCTION

This report and the five appendices that follow present the detail supporting the Pension Benefit Guaranty Corporation's (PBGC or the Corporation) request for Congressional approval of an increase in the premium for the single-employer basic benefits program. The Corporation is requesting an increase from \$2.60 per participant to \$6.00 per participant effective January 1, 1983. The background and basis for this recommendation are discussed in this paper.

The PBGC currently maintains two statutorily required insurance programs:

- o The first program covers guaranteed benefits in terminating single-employer plans. PBGC incurs a net claim when the value of a terminated plan's guaranteed benefits exceeds the sum of the plan's assets and the amounts recoverable in employer liability payments from the sponsoring employer.
- o The second program requires the PBGC to guarantee certain benefits in multiemployer plans when the plan's assets are not adequate to pay them. These guarantees are to be provided through financial assistance from PBGC to the plan, normally in the form of loans. A claim is incurred when

subsequent contributions to the plan by the sponsoring employers are insufficient to repay the loan provided by PBGC.

Each of these programs is separately financed by a premium charged for each participant covered by the respective programs. The assets of one program cannot be used to pay claims incurred under the other program.

This report addresses only the need to increase the single-employer premium. 1/ That premium is currently \$2.60 per participant in plans covered by the program. 2/ In FY81, this program produced \$75.0 million in revenue from over 90,000 plans with about 28 million participants.

1/ The multiemployer program was restructured by the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA). The premium in this program is currently \$1.40 and is scheduled to increase periodically - reaching a level of \$2.60 in September, 1988. Based on the Corporation's experience to date under MPPAA, the Corporation has no basis to request a change in this premium.

2/ Section 412 of MPPAA directs the Corporation to study the advantages and disadvantages of charging the premium on a risk-related basis, rather than continuing to charge it on a per-capita basis. The PBGC has begun a study on the possibility of adopting a risk-related premium for the single-employer program and expects to make its findings available next year.

The premiums produced by this program are used to 1) pay the benefits of participants in terminated insufficient pension plans covered by this program, and 2) pay the administrative costs of the Corporation.

III. BACKGROUND

A. History of the Premium

The Employee Retirement Income Security Act of 1974 (ERISA) established the single-employer premium at \$1.00 per participant. A premium study conducted by the PBGC in 1977 resulted in the Corporation requesting an increase in that premium. In December 1977, Congress approved a premium increase to \$2.60 per participant for plan years beginning on or after January 1, 1978.

When the previous premium study was performed in 1977, it was pointed out that the amount being requested to finance the program was determined using "... an analysis of insufficient plans that have terminated to date, as well as projections of the likely number and characteristics of future insufficient terminations, based upon that experience". 3/ That study anticipated no need to increase the premium before January 1, 1982.

3/ Pension Benefit Guaranty Corporation, Premium Requirements for the Single Employer Basic Benefits Insurance Program, September 1977, Page I-3.

As discussed in Section C of this paper, the magnitude of net claims incurred since that study has increased markedly. Therefore, the need to request an increase at this time is consistent with the position previously taken by the PBGC. A more detailed examination of how PBGC's experience has changed since the time of the 1977 study is provided in Appendix E.

B. Status of the Deficit

The financial statements of the Corporation for the year ending September 30, 1981 report that the deficit of the single-employer program is \$188.8 million. ^{4/} This means the present value of guaranteed benefits in plans that have already terminated exceeded the assets of this program by that amount on September 30, 1981. A copy of the PBGC's Fiscal 1981 Financial Statements is provided at Exhibit 1.

^{4/} The General Accounting Office (GAO) conducted an audit of PBGC's financial statements for the year ending September 30, 1980. The GAO is expected to disclaim an opinion for the year ending September 30, 1980. The GAO is not expected to audit the statements for the year ending September 30, 1981. A disclaimer means the auditor has not obtained sufficient competent evidential matter to form an opinion on the accuracy of the financial statements. In PBGC's case the disclaimer is principally due to GAO's concerns regarding the estimating of the amount of liability for the present value of guaranteed future benefits.

The GAO in its audit did not assert that the amounts arrived at for the liability for the present value of guaranteed benefits were incorrect, but rather that the data available was inadequate to support the estimate for this item.

The Corporation projects that, if the premium is not increased, the deficiency in assets will continue to grow. By January 1, 1983 (the date on which the PBGC recommends that the increase be effective) the deficit is expected to increase to approximately \$236.3 million. Without a premium increase, this deficit is expected to continue growing at an increasing rate. It is anticipated that the deficit will increase by \$38 million in FY82. The growth will become progressively larger in each year so that the increase is expected to be \$74 million by FY86. Thus, by the end of 1986 (the end of the 5-year forecast period covered by this report) the deficit could be as high as \$470 million. If the premium is increased as requested, the deficit is expected to be eliminated at the end of 1987. (See Chart I.)

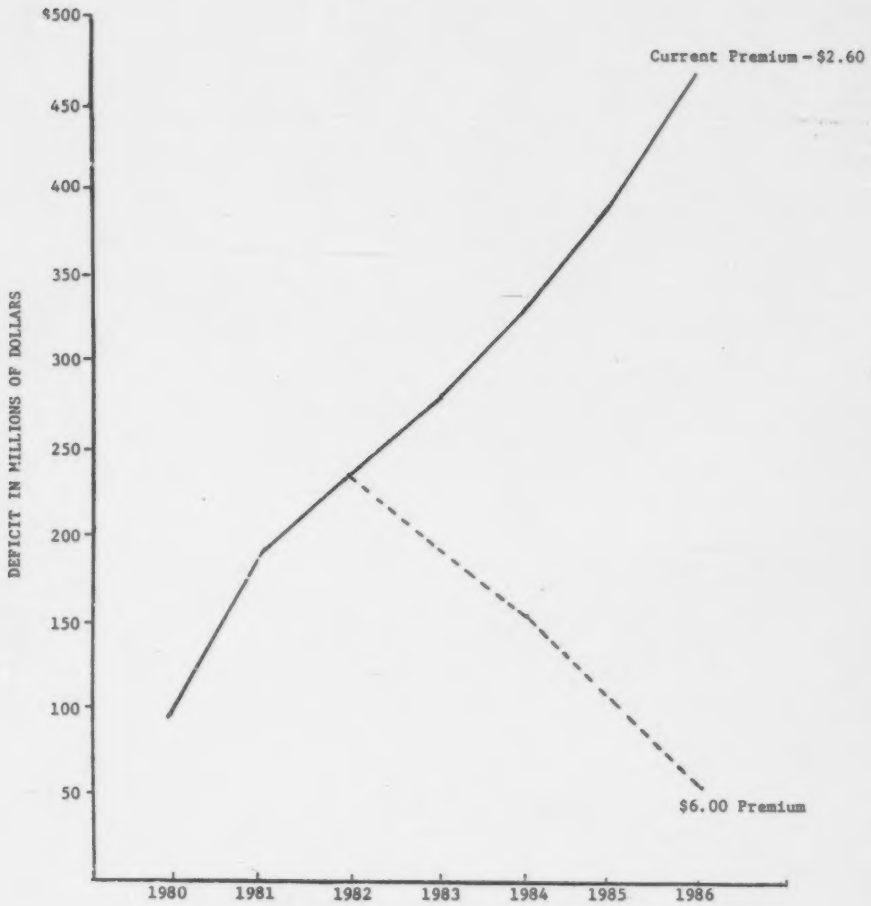
(Continued from page 14)

GAO's concerns with the present value of guaranteed benefits include the estimation of how these values change after the date of termination. It was also concerned with the need to estimate the value of the claims for terminated plans still in process. However, because of the time involved in claims processing, the need to estimate will always be present in PBGC's statements. This need to estimate is also present in most private insurance companies' financial statements.

In connection with their audit of the Corporation's financial statements for September 30, 1980, the GAO has noted that the PBGC has made substantial improvements in eliminating the deficiencies covered in their previous report (1977). The PBGC is undertaking further major efforts to improve its statements. This includes directly measuring liabilities through an individual participant valuation system. While the PBGC is continuing its efforts to meet the concerns expressed by the GAO, I believe that those concerns (while significant) are not so serious as to cause any doubt that a significant premium increase is required.

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CHART I
IMPACT OF PREMIUM INCREASE ON DEFICIT



In contrast, the deficit was only \$41 million in 1977 when the previous study was done. The deficit was projected to decline to \$34 million by January 1, 1982 and be eliminated entirely by December 31, 1987.

C. Claims Experience

The primary reason for the differences between the findings in the 1977 study and the current projections is the substantial change in the number and value of large claims that have occurred since the previous study was conducted. As illustrated in Table 1, PBGC's claims experience and, therefore, its premium needs, is very sensitive to "large claims" (those in excess of \$1 million). During the first seven years of the program, 54 "large claims" were incurred. However, only 11 of these "large claims" occurred in the 2 1/2 years before the prior premium increase was requested, while 43 of these "large claims" occurred in the subsequent 4 1/2 years. While these "large claims" represent less than 11.2% of PBGC's total number of claims, they account for 88.1% of the value of net claims. By number of large claims, the annual average has more than doubled, going from a rate of 4.4 to 9.6 per year. In value, however, the annual average has almost tripled, from \$19.3 million to \$56.3 million.

The number of "very large claims" (those in excess of \$10 million) increased from two during the period of the prior study to six during the subsequent 4 1/2 years. The total value of these "very large claims" increased from \$29.3 million during the former period to \$151.4 million during the latter period.

Similarly, the largest claim experienced when the previous study was undertaken was \$16.5 million. In contrast, the largest claim to date is now almost \$60 million.

When the previous study was done, a rate of 83 claims per year was observed. In the last 4 1/2 years this rate declined to 61 claims per year. This decline is more than offset by the fact that the average claim increased from \$297,000 during the first 2 1/2 years to \$1,022,000 in the most recent 4 1/2 years. The annual claims rate was \$24.7 million per year when the last premium study was done; it is now \$62.3 million per year. Annual claims are now 2 1/2 times what they were previously. This increase is the principal reason why the premium now needs to be increased.

TABLE 1
Net Claims Experience - FY75 - FY82

Number of Net Claims 2/	<u>Sept.1974-Mar.1977</u> ^{1/} / <u>April 1977-Sept.1981</u>				Preliminary FY82 Experience
	<u>Number</u>	<u>% of Total</u>	<u>Number</u>	<u>% of Total</u>	<u>Number</u>
"Very Large" Net Claims (Claims over \$10 million)	2	1.0%	6	2.2%	1
"Large" Net Claims (Claims over \$1 million)	11	5.3%	43	15.7%	3
Total Number of Net Claims	208	-	274	-	N/A
<u>Amount of Claims (\$ in millions)</u>	<u>Amount</u>	<u>% of Total</u>	<u>Amount</u>	<u>% of Total</u>	<u>Amount</u>
Total "Very Large" Net Claims	\$29.3	47.3%	\$151.4	54.0%	\$58.3
Total "Large" Net Claims	\$48.2	77.9%	\$253.2	90.4%	\$67.0
Total Value of Net Claims	\$61.9	-	\$280.2	-	N/A
Largest Net Claim	\$16.5	26.7%	\$ 40.5	14.5%	\$38.3

1/ This is the period covered by the PBGC's 1977 Premium Study.

2/ Net claims are defined as one or more plan terminations resulting from a single action of a plan sponsor that causes a charge against the premium system.

N/A = Not Available.

The PBGC has also examined why the average claim per terminated plan has increased since the time the 1977 study was done. The Corporation found that the increase is due to:

- (1) the number of participants per terminated insufficient plan is substantially larger than forecast,
- (2) the value of guaranteed benefits in terminated plans is larger than forecast, and
- (3) a substantially smaller percentage of unfunded liability of the terminated plan is being recovered in the form of employer liability. These points are further discussed in Appendix E.

D. Characteristics of Benefits Guaranteed by PBGC

The PBGC is currently responsible for paying benefits to over 80,000 participants of terminated insufficient pension plans. ^{5/} A distribution of the monthly benefits currently being paid directly by the PBGC is shown in Table 2.

^{5/} This total includes both deferred vested participants, and those participants in PBGC-trusted or about-to-be trusted plans presently being paid by the prior trustee.

TABLE 2

Distribution of PBGC's Monthly Benefit Payments

<u>Monthly Benefit Amount (In Dollars)</u>	<u>Number of Participants</u>	<u>Percentage of Participants</u>	<u>Value of Monthly Guaranteed Benefits (In Thousands)</u>	<u>Percentage of Monthly Guaranteed Benefits</u>
\$ 1 - \$199	22,083	81.7%	\$1717.3	53.3%
\$200 - \$499	4,721	17.5%	1338.3	41.5%
Greater than \$500	<u>241</u>	<u>0.8%</u>	<u>166.0</u>	<u>5.2%</u>
Total	27,045	100.0%	\$3221.6	100.0%

Although the current monthly maximum benefit is \$1380.60, the average benefit being paid by the Corporation is currently \$119.12 per month.

E. PBGC's Exposure

While the size of PBGC's claims has risen materially, it is possible that even larger claims will be incurred in the future. In order to ascertain the Corporation's exposure, the PBGC reviewed the total unfunded liability of pension plans as reported in corporate annual reports. This survey showed that corporations with the 50 largest unfunded vested liabilities had unfunded liabilities of approximately \$15 billion. ^{6/} The smaller unfunded liabilities of other publicly traded firms totalled another \$5 billion. Thus, it can be said PBGC's exposure is at least 250 times the annual claims rate it has been experiencing.

^{6/} This value is based upon vested benefits rather than the benefits the PBGC would guarantee. Also, the liabilities were valued using interest rates selected by a particular plan's actuary. In many cases, PBGC's rates would produce different results. Therefore, while not a direct measure of PBGC's exposure, the analysis does indicate its potential magnitude. The PBGC estimates that unfunded guaranteed benefits are about 75% of the unfunded vested liability as reported in corporate financial statements. This study is discussed in more detail in Appendix C.

Furthermore, the PBGC followed the course of financially troubled firms with large underfunded plans. Based on this review, thirty-four such firms have been identified with an estimated \$4.4 billion in unfunded vested liabilities. These values reflect the interest rate assumptions utilized by their actuaries. ^{1/} This matter is discussed in more detail in Appendix C.

It is PBGC's experience that a majority of the net claims to the insurance system are the result of the bankruptcy or failure of an employer sponsoring an underfunded pension plan. Unfortunately, while it is possible to identify plan sponsors who are experiencing financial difficulty, it is impossible to forecast the rate of such business failures and the claims that would result from such failures accurately.

^{1/} These firms were identified by a) bond ratings, b) a bankruptcy prediction score (Zeta), c) Value Line Safety Factor, or d) a sharp decline in stock prices. The liability values are based on published financial statements for fiscal years beginning in 1980. These unfunded liabilities may have changed since then.

IV. BASIS FOR REQUESTED PREMIUM INCREASE

A. Overview

Consistent with the approval previously endorsed by Congress, the Corporation bases its current recommendation on the premise that PBGC's claims should be "currently funded". This means that assets on hand, together with the earnings expected thereon, will be sufficient to pay all liabilities assumed by the Corporation at any given time. In contrast, "pay as you go" funding only requires that assets on hand be sufficient to pay specific monthly pension benefits when they fall due.

"Current funding" results in having plans insured during a given period bear the cost of claims incurred during that period. Thus, current funding avoids, to the maximum extent possible, having pension plans in the future assume the burden for financing the cost associated with past insufficient plan terminations. Moreover, it tends to minimize the need for very large premium increases in the future, thereby minimizing the potential for future increases having a destabilizing influence on the continuation of covered defined benefit pension plans. The only alternative, if this point were reached, would be to finance the

program from general revenues. Finally, "current funding" minimizes the likelihood of the PBGC having to exercise its borrowing authority from the U.S. Treasury.

Under a "pay as you go" approach, the Corporation would fund its liability in a manner inconsistent with sound financial practices. From a programmatic point of view, such a funding policy would shift the responsibility for claims of today's terminations to future generations of plans and their sponsors. This, in the PBGC's judgment, is not equitable. Furthermore, the longer the increase is delayed, the larger the ultimate increase must be. The PBGC believes that the program should be funded in such a way as to (1) minimize the likelihood of needing to exercise its borrowing authority from the U.S. Treasury or 2) needing to seek legislation to finance its liabilities from general tax revenues rather than premium income.

The six components which this premium analysis considered were:

- o the amount of future net claims,
- o the administrative costs of the program,
- o the amount of the current program deficit to be retired and the length of time used to retire the deficit,
- o the size of a reserve for unexpected contingencies (if any),
- o the number of participants for whom a premium will be collected, and
- o the date the premium increase becomes effective.

The contribution of each component to the recommended premium level of \$6.00 is summarized in Table 3.

TABLE 3

Components of the Requested Premium

	Cost Per Participant <u>1/</u>	Percent of <u>Premium</u>
Financing of expected future net claims	\$3.02	50.9%
Administrative expenses	.97	16.3
Retirement of the expected December 31, 1982 deficit over 5 years	1.95	32.8
Accrual of Reserve for contingencies	<u>0.00</u>	<u>0.0</u>
Total	\$5.94 <u>2/</u>	100.0%

1/ Assumes that the 28,300,000 participants in covered plans during FY81 will continue to grow at a rate of 1.1 million participants per year. This assumption is based on the actual rate of growth in the number of participants between 1975 and 1981. If the number of participants in the program does not continue to grow, the premium will need to be \$6.74.

2/ For purposes of this request, this value has been rounded to \$6.00. The actual amount calculated, \$5.94, is used throughout the remainder of this report to show the sensitivity of the premium to changes in various assumptions.

This table assumes the premium increase becomes effective January 1, 1983. If this increase is delayed by one year, the premium would have to be approximately \$6.79 if the deficit is to be amortized by 1987. Because 70% of PBGC's income is tied to plan years that begin in January, a delay of even one month would require that the premium be raised to \$6.56.

B. Forecast of Future Claims

This component is the most difficult to estimate and is subject to the most uncertainty.

A net claim is incurred when the value of a terminated plan's guaranteed benefits (gross claims), exceeds the value of the plan's assets plus the amounts recoverable from the sponsoring employer (employer liability).

In order to estimate the level of future net claims, the PBGC attempted to relate both the frequency and value of net claims to past economic activity. Given that PBGC's net claims are primarily caused by the failure of businesses, it is reasonable to hypothesize that a relationship exists between past economic activity and PBGC's claims experience. If such a relationship could be established, and future economic activity correctly forecast, it would be possible to forecast the level of future claims and, in turn, PBGC's premium needs. This of course does not mean that individual "very large claims" would be successfully forecast.

This approach was used in the 1977 premium study. That study showed that a relationship could be expected to exist between the level of insufficient plan terminations and the unemployment rate.

The significance of that relationship was not borne out when tested using more recent experience. Other recent attempts to find a relationship between PBGC's claims experience and relevant economic variables have also been unsuccessful. ^{8/} The various approaches studied are discussed in more detail in Appendix D.

Because no statistical relationship could be established with relevant economic variables, PBGC based its forecast of future claims on an extrapolation of its past experience.

As discussed in Appendix A, analysis of PBGC's claims experience showed that total annual claims have grown at an annual rate of about \$8.3 million or about 9%. This increase is consistent with the fact that for some covered plans, benefits are tied to final earnings of participants. The amount of benefits insured by the PBGC in such plans will grow along with annual earnings of participants. Similarly, most other plans for which PBGC guarantees benefits use a unit-benefit approach (e.g. \$5.00 per

^{8/} Variables that were tested without success include: 1) the unemployment rate, 2) Gross National Product (GNP), 3) rate and current liabilities of business failures, 4) inflation as measured by the GNP price deflator, 5) the index of credit rationing, 6) money supply (M2), 7) corporate profits, 8) industrial production index, 9) prime commercial bank rate, 10) capacity utilization in manufacturing, 11) time trend series, and others. These variables were tested against both the value and frequency of PBGC's claims on both a lagged and unlagged basis.

year of service). For these plans, the amounts guaranteed by the PBGC increase as plan sponsors grant benefit increases. ^{9/}

As discussed in Appendix A, this analysis also took into account that, over the last seven years, plan liabilities have been valued using the interest rate in effect on the date a plan terminates. The rate for valuing immediate annuities has risen from a low of 6.75% to 10.25%, as of September 30, 1981. Since interest rates have been rising, the value of recent net claims has been less than what would have been reported if interest rates had not increased. In order to eliminate the effect of increasing interest rates, the liability values as of the date of plan termination were adjusted to reflect the 10.25% interest rate.

Thus, this analysis assumes that the rate of growth in net claims that the PBGC has experienced to date will continue. Annual net claims are expected to average \$96.8 million over the next five years. This level of claims, along with administrative expenses and the amount required to retire the deficit over five years, produce a premium requirement of \$5.94. ^{10/}

^{9/} PBGC's guarantee of these unit-benefit increases occurs with a delay due to the phase-in provisions of Section 4022 of ERISA. For a plan using a five-year earnings average, it is several years before the impact of past salary increases is fully reflected in the amount of PBGC claims.

^{10/} This has been rounded to \$6.00 for the purpose of PBGC's premium request. (See Table 3, Footnote 2)

While this recommended premium level does not make any allowance for the possibility of some extraordinarily large claims, it will still permit more flexibility if larger than expected claims occur. Seeking a premium at this level reduces the possibility that the PBGC will need to return to Congress in the near future for an additional premium increase. At the same time, there is not a great likelihood that if claims are less than forecast, a program surplus will be created. This is because the existing deficit (\$188.8 million) must be retired first.

Alternate Approaches to Claims Forecasting

In order to test the sensitivity of the premium to alternative assumptions, two alternative projections were made. They were:

- 1) PBGC's net claims will be equal to the average annual amount experienced over the last 4 1/2 years (Alternate Assumption 1) and
- 2) PBGC's net claims will be equal to the average annual amount experienced since the inception of the program in 1974 (Alternate Assumption 2).

In contrast to the forecasting method recommended in this study, neither of these assumptions reflect the significant growth trend in claims experienced to date. Alternate Assumption 1 (required premium \$5.44) recognizes that PBGC has experienced significantly

larger claims in the last 4 1/2 years than in the previous 2 1/2 years. However, it assumes that the value of net claims will stop growing. Given the PBGC's current exposure (discussed in Appendix C), this is not a realistic assumption.

Furthermore, Alternate Assumption 2 (required premium \$4.70) does not recognize any trend in PBGC's claims experience since the early days of the program. Moreover, it assumes that future claim levels will decrease below current experience.

While the projection of PBGC's claims will in any event be somewhat uncertain given the difficulty in predicting the future, the PBGC has evaluated both of these alternative assumptions, and judged them to not be a realistic basis for projecting the Corporation's future claims and, therefore, its premium needs.

C. Administrative Costs

The recommended premium includes a provision for administrative expenses as in the 1983 budget. For the period 1984 through 1986, the same staffing level is assumed. Administrative costs were increased by the projected increase in the Consumer Price Index. If the real level of administrative costs varies by $\pm 10\%$, it would have a \$.10 impact on the recommended premium. If no inflation is assumed beyond 1983, the required premium would be \$.08 less.

D. Retirement of the Deficit

The single employer insurance program was underfunded by \$188.8 million as of September 30, 1981. Before the increase can become effective on January 1, 1983, the deficit is expected to increase to \$236.3 million (see Table 4).

This deficit has arisen because PBGC's net claims and administrative expenses have exceeded its premium revenue. As discussed in Appendix B, PBGC's actuarial adjustment and investment income have been almost equal to each other since the inception of this program; the Corporation's deficit has not resulted from PBGC's investment performance being less than what is required by its actuarial adjustment.

In general, the actuarial adjustment should be related to the amount of the investment income. In the case of a fully funded pension plan earning exactly its actuarial assumption, the actuarial adjustment and the investment income would be offsetting. PBGC's experience to date shows that these amounts are almost equal (\$55.8 million vs. \$56.5 million). Because PBGC values both its assets and liabilities on a market value basis, this indicates that to date the interest rate fluctuations on both financial and annuity markets have had approximately offsetting impacts on PBGC's financial condition.

TABLE 4

Summary of Financial Condition
 Single-Employer Basic Benefits Program
 as of September 30, 1981 and December 31, 1982
 (\$ Million)

	Inception to Sept. 30, 1981	Inception to Dec. 31, 1982 (Projected)
<u>Revenues</u>		
Premium Income	\$336.6	\$431.5
Investment and Other Income	<u>55.8</u>	<u>126.7</u>
Total Revenues	\$392.4	\$558.2
<u>Expenses</u>		
Losses on terminated plans and plans pending termination	\$429.8	\$535.2
Actuarial Adjustment <u>1/</u>	56.5	132.3
Administrative Expense	<u>94.9</u>	<u>127.0</u>
Total Expenses	\$581.2	\$794.5
Income over (under) expenses	\$ (188.8)	\$ (236.3)

1/ The actuarial adjustment reflects 1) charges caused by the passage of time that shortens the discount period before benefit payments are scheduled to be paid and 2) charges due to changes in the interest rate between the date of plan termination and the financial statement date. Both PBGC's assets and liabilities are reported on a market value basis.

The impact of interest rates on PBGC's premium requirements is discussed more fully in Appendix B.

Despite its current deficit, the PBGC has a high degree of liquidity. Over \$348 million is presently available to pay future benefits. Because of the extended period over which the PBGC pays the claims it incurs, the deficit need not be eliminated immediately. However, because of the potential of extraordinarily large claims occurring, the Corporation recommends retiring the deficit over five years. Table 5 shows the impact of retiring the deficit over various periods of time.

A 5-year retirement period has several important advantages:

- o it provides greater flexibility for the Corporation to meet future large claims should they occur,
- o it establishes the program on an financially prudent basis as soon as possible, by eliminating the deficit by 1987, and
- o it more closely matches premium collections with the recognition of claims.

TABLE 5
Impact of Retirement Period
on Required Premium

<u>Retirement Period</u> (in years)	<u>Cost Per Participant</u> <u>1/</u>	<u>Required Premium</u>
5	\$1.95	\$5.94
10	1.21	5.20
15	0.98	4.97
20	0.88	4.87
30	0.80	4.79

1/ Based on an average of 32.1 million participants per year and amortizing the deficit at 10 1/4%.

Thus, a 5-year period is consistent with the PBGC's policy, which has had prior Congressional approval, of "current funding" for its claims without unreasonably increasing the required premium in the near term. Using a 5-year period to retire the deficit does not impair PBGC's cash flow requirements and creates very little risk of the PBGC needing to exercise its borrowing authority from the U.S. Treasury.

E. Establishment of Reserve for Unexpected Contingencies

This request for a premium increase is based upon an extrapolation of PBGC's experience to date. This experience includes no individual claims larger than \$60 million. As pointed out above, the Corporation is aware of financially troubled sponsors who are maintaining plans that are underfunded by substantially more than \$60 million.

The largest claim the PBGC could incur as a result of the failure of a financially troubled sponsor could well be 50 times the largest claim it has incurred to date and about 10 times the total claims it has experienced to date. The premium necessary to create a reserve large enough to cover such a claim would be much higher than the \$6.00 now being recommended.

In developing this premium request, no specific provision was made for a reserve or surplus to protect the Corporation against large claims or any other unexpected contingencies. In the Corporation's judgment, accumulation of a surplus is unnecessary because of the compulsory nature of the insurance program. Moreover, most large plans have sufficient assets to pay benefits for a few years and PBGC does not have a current liquidity problem. Finally, the Corporation may borrow up to \$100 million from the U.S. Treasury. Table 6 illustrates the premiums that would be necessary to build reserves of various sizes by the end of 1986, if a reserve were deemed necessary. The table also illustrates the impact that an unexpected claim of the magnitudes shown will have on the premium if the claim were to be funded by the end of 1986.

F. Number of Participants

The number of participants in the single-employer program is another critical component of the analysis. It determines the number of units over which the revenue necessary to finance claims and administrative costs can be charged.

TABLE 6

Premium Required to Establish Contingency Reserves 1/

<u>Size of Reserve by 1986</u>	<u>Required Increase (over \$5.94)</u>	<u>Required Premium</u>
	(\$ per participant)	(\$ per participant)
\$100 million	\$.67	\$6.61
\$500 million	3.35	9.29
\$ 1 billion	6.70	12.64

1/ Until the present deficit is completely retired, the true reserve built up for future claims will be the targeted reserve amount, less the amount of the unretired deficit.

The analysis which underlies PBGC's recommendation is based on 28.3 million participants in the single-employer program during the fiscal year ending September 30, 1981. Analysis of PBGC's premium receipts since 1975 indicates that the number of participants in the single-employer program has been growing at a rate of about 1.1 million participants per year. This study assumes that this rate of growth will continue. If participation does not continue to grow and the number of participants remains at 28.3 million, the premium should be increased to \$6.74, an additional increase of \$.80.

G. Effective Date of Premium Increase

This analysis assumes the increase will become effective January 1, 1983. The deficit is expected to grow at an average rate of \$58 million per year in the absence of an increase. If the effective date of the increase is delayed to January, 1984, the deficit is projected to increase to \$277 million. Thus, because of the large deficit to be amortized, a delay of one year in effecting the increase will require a premium increase of an additional \$0.85 to \$6.79, if the deficit is to be retired by the end of 1987. If the deficit were to be retired over five years, starting January 1, 1984, the premium would need to be \$6.35.

It is also very important that any premium increase be effective for plan years beginning on or after January 1. Over 73% of covered plans have plan years beginning in January. Therefore, a delay of even one month in the effective date of the increase will result in most plans paying the current premium (\$2.60) for one more year. In that case, the required premium would be \$6.56, if the deficit were to be retired by the end of 1987.

V. OTHER KEY ASSUMPTIONS

In developing this analysis, several other key assumptions were made. They are discussed below:

A. Legislative Changes

The Corporation has assumed that PBGC's experience to date will continue in the future. This includes the assumption that the magnitude of "abusive" type claims will remain unchanged. However, as previously noted, the potential exists for such "abusive" type claims to increase materially in the future. This is a primary reason why the Administration is supporting legislation to change the nature of the insurable event under the single-employer insurance program. 11/ One important objective of this proposed

11/ See S. 1541 and H.R. 4330, Retirement Income Incentives and Administrative Simplification Act (The Nickles-Erlenborn Bill).

legislation is the elimination of the incentives to create claims against the insurance system when there is no need to do so. This includes situations where an on-going sponsor terminates its pension plan because the unfunded liability of the plan greatly exceeds the amount of its statutory employer liability to the PBGC (presently limited to 30% of sponsor net worth). The legislation would also protect PBGC premium-payers in situations involving the transfer of unfunded pension liabilities in connection with the sale or spinoff of a business to a weak entity which, because of the 30% net worth limit under current law, would not be fully liable if the underfunded pension plan subsequently terminates.

While the potential for huge losses from these types of claims exists, to date such claims have constituted about 20% of PBGC's net claims. The PBGC has assumed for purposes of this premium recommendation, that this historical experience will continue at the same rate; and accordingly, has estimated that enactment of corrective legislation would result in the recommended premium being reduced by \$.58 to \$5.36. There is a great risk, however, that if TITLE IV is not amended, the number of "abusive" type claims will materially increase. This would require a substantial increase in the premium, over and above the amount of this recommendation. Although the amount of such an increase cannot be projected with a high degree of certainty, a premium well in excess of \$10.00 could be required if "abusive" claims increase substantially.

B. Investment and Actuarial Assumptions

This analysis assumes that once an insufficient plan terminates and enters PBGC's trusteeship, no further gains or losses to the Corporation will result from subsequent investment or actuarial experience. As discussed in Section IV. D., this is consistent with PBGC's experience through September 30, 1981. The Corporation believes this is a realistic assumption, since the PBGC values its liabilities upon termination in a manner consistent with that used by private insurers. Given current valuation assumptions, PBGC needs to earn about 10 1/4% on its assets.

In addition, PBGC's investment return should be evaluated in comparison with its actuarial adjustment. The actuarial adjustment includes the impact of changes in the market value of PBGC's liabilities due to interest rate changes. Both PBGC's assets and liabilities are valued at market, and changing interest rates will have an impact on the market value of both. Rising interest rates will tend to reduce the value of PBGC's assets and reduce the value of PBGC's liabilities. Decreasing interest rates will have the opposite effect. Therefore, as long as changing levels of interest rates have an offsetting impact on both sides of the balance sheet, there should be little impact on PBGC's overall financial condition. Appendix B discusses further the effect of changing interest rates on the market value of PBGC's assets and liabilities.

PBGC also evaluated the impact that valuing the Corporation's assets and liabilities at different interest rates would have on the premium recommendation. For this purpose, the Corporation

- restated its liabilities at the alternative interest rates,
- assumed the alternative interest rate would have also affected the market value of its assets,
- amortized the adjusted deficit value at the alternative interest rate, and
- projected future claims on the basis that they were also valued at the alternative interest rate.

When this was done, the PBGC found that valuing the program at 8% (rather than the current assumption of 10 1/4%) would require a premium of \$6.81. Conversely, valuing the program at 13% would require a premium of \$5.24. However, both of these values probably overstate the impact of changing interest rates. If interest rates decline to 8% the economy could improve materially, thereby possibly reducing the number of PBGC's claims and therefore PBGC's premium needs. In contrast, if interest rates were 13%, more business failures may occur, thereby increasing PBGC's premium needs.

The only other critical actuarial assumption is mortality. In the absence of a major medical break-through, there is no reason to believe these assumptions (which are consistent with the experience and assumptions utilized by private pension plans) will not be realized. The specific mortality assumptions used are found in PBGC's Valuation of Plan Benefits regulation (29 CFR 2619).

C. Continuation of Current Experience

No further change in the premium is expected to be required before January 1, 1987 unless experience differs substantially from that projected.

This experience shows that claims can be expected to increase at a rate of about 9% per year. If claims greatly exceed current projections the PBGC may have to recommend a premium increase at an earlier date. If actual claims decline, the current deficit of \$188.8 million may decline more rapidly than projected. The Corporation does not anticipate eliminating the deficit before 1987. If this occurs, and future claims are not expected to materially increase, the PBGC will be able to recommend a reduction in the premium in the future.

VI. IMPACT OF THE PREMIUM INCREASE

Although it represents a significant increase, the requested premium is still a very small percentage of a typical pension plan's annual costs and an even smaller portion of a typical employer's annual payroll. Based on data gathered annually by the U.S. Chamber of Commerce, 12/ the \$6.00 premium will still represent:

- o less than 1% of the annual cost to a typical employer of maintaining a pension plan,
- o about 1/10 of 1% of a typical employer's annual payment for all employee benefits,
- o about 4/100 of 1% of typical annual payroll costs, and
- o about 3 mills per hour worked.

12/ Employee Benefits 1980, Chamber of Commerce of the United States.

Therefore, the PBGC believes the proposed premium would still be modest when weighed against the amount of protection provided. The requested increase of \$3.40 per participant represents a much smaller unplanned increase than could result from having to fund an unexpected actuarial loss. Accordingly plan administrators should not experience difficulties paying the increased premium.

If it is decided that plans should be given more time to adjust to a higher premium, the premium could be phased-in over three years. If this approach is considered, all steps of the premium increase should be approved at one time. Because of the income foregone while the lower premiums are being charged, the ultimate premium required under such an approach would need to be greater than \$6.00. One possibility would be to increase the premium to \$4.00 effective January 1, 1983, to \$5.50 effective January 1, 1984 and to \$7.10, effective January 1, 1985. Obviously, making the size of the individual premium increases smaller or waiting longer between increases means that the ultimate premium level would have to be higher than \$7.10.

VII. TIMING OF INCREASE

The PBGC requests that the premium increase be effective for plan years beginning on or after January 1, 1983. January 1 is a critical date since over 70% of PBGC's revenue is produced from

plan years that begin on that date. Therefore, delaying the effective date of the increase beyond January 1 effectively delays the increase for a year. As pointed out earlier, a year's delay would require increasing the requested premium to \$6.79 if the deficit is to still be eliminated by the end of 1987, or \$6.35 if it is to be eliminated by the end of 1988.

VIII. RECOMMENDATIONS

The present premium of \$2.60 is not adequate to finance the claims of the single-employer basic benefits program on an financially prudent basis. The sooner this increase is implemented, the lower the ultimate premium required.

Therefore, it is recommended that PBGC's single-employer premium be increased to \$6.00 effective January 1, 1983.

This premium increase will:

- o make allowance for the fact that PBGC's claims are growing;
- o minimize the chances of having to request Congressional approval for another premium increase before 1987;
- o permit the deficit in the single-employer program to be eliminated as quickly as is practical; and
- o place the program in the best possible position to respond to adverse experience, particularly larger claims than it has experienced to date.

PBGC SINGLE-EMPLOYER PROGRAM SELECTED FINANCIAL DATA
(In Millions of Dollars except for Participants Receiving Guaranteed Benefits)

	<u>FY 75</u> (10 months)	<u>FY 76</u> (15 months)	<u>FY 77</u>	<u>FY 78</u>	<u>FY 79</u>	<u>FY 80</u>	<u>FY 81</u>
Premium Income	18.5	29.7	25.1	47.4	69.7	71.2	75.0
Investment & Other Income	<u>0.9</u>	<u>7.0</u>	<u>5.7</u>	<u>9.6</u>	<u>17.7</u>	<u>22.3</u>	<u>(5.4)</u>
TOTAL REVENUE	19.4	36.7	30.8	57.0	87.4	93.4	69.6
Losses on Terminated Plans & Plans Pending Termination	31.2	43.1	59.2	63.6	68.2	26.3	140.6
Administrative Expense	2.8	9.9	12.0	14.0	15.8	19.8	20.6
Actuarial Adjustment	<u>1.1</u>	<u>9.0</u>	<u>13.9</u>	<u>21.9</u>	<u>12.0</u>	<u>(4.4)</u>	<u>2.5</u>
TOTAL EXPENSES	35.1	62.0	85.1	99.4	96.0	41.6	163.8
INCOME OVER (UNDER) EXPENSES	<u>(15.7)</u>	<u>(25.3)</u>	<u>(54.3)</u>	<u>(42.4)</u>	<u>(8.6)</u>	51.8	<u>(94.2)</u>
Assets:							
Investments	29.3	69.3	91.8	151.7	223.6	288.6	346.3
Assets Excluding Investments <u>1/</u>	<u>25.1</u>	<u>58.0</u>	<u>84.0</u>	<u>92.9</u>	<u>108.7</u>	<u>177.9</u>	<u>180.1</u>
TOTAL ASSETS <u>1/</u>	54.4	127.3	175.8	244.6	332.3	466.5	526.4
Liabilities:							
Reserve for Present Value of Guaranteed Benefits <u>2/</u>	58.3	159.0	260.0	365.0	460.0	543.0	696.0
Liabilities Excluding Reserve	<u>11.8</u>	<u>9.3</u>	<u>11.1</u>	<u>17.4</u>	<u>18.7</u>	<u>18.1</u>	<u>19.2</u>
TOTAL LIABILITIES <u>2/</u>	70.1	168.3	271.1	382.4	478.7	561.1	715.2
EQUITY (DEFICIT)	<u>(15.7)</u>	<u>(41.0)</u>	<u>(95.3)</u>	<u>(137.8)</u>	<u>(146.4)</u>	<u>(94.6)</u>	<u>(188.8)</u>
Memo:							
Benefit Payments	1.5	9.5	13.0	28.1	32.3	36.7	56.8
Number of Participants Receiving Guaranteed Benefits	400	6,000	16,000	27,000	43,000	55,000	71,200

1/ FY 80 and FY 81 include Assets and Employer Liability of Plans Pending Termination.

2/ FY 80 and FY 81 include Reserve for Present Value of Guaranteed Benefits of Plans Pending Termination.

Senator NICKLES. You mentioned a couple of things that I would like to point out. If a private insurance company would not have a deficit, they would have premiums built up to the case where they would be actuarially sound.

Let me ask you a couple of questions. PBGC, to me, seems like it is a far cry from any insurance system that I have seen. You have no risk related premium.

Do you think maybe that would be a step for us to go, and here again I realize that you have not been in this hotseat for very long and I am not trying to put you in any. If you care to defer on any of these questions let me know. I am not trying to pin you down but, we do not have a risk related premium, and maybe this is part of my contention, that a \$6 premium is going to get people upset because they are fully funded, and perhaps they will never draw a dime of PBGC money. They know those turnaround subsidizing unfunded plans have been mismanaged for years, and that draws the ire of a lot of people. I think it is important that it dilutes the effect because many people have fully funded plans and will not have a draw on PBGC. Therefore, they are just subsidizing other plans.

Mr. JONES. If you'd like a comment, Senator, I will give a brief comment.

I fully understand how you feel about the matter, and actually there is a paper that I wrote sometime ago that discusses that very point, but it is a very hard thing to assess as I look at it in the context of what the purpose of Congress is. The purpose of Congress was to protect the workers of these underfunded plans. If we did not have underfunded plans, we would not have a problem. The assets would be equal to cover all the plans just as they are in most, if not every, insurance company. So that the very heart of what we have done is to insure really uninsurable plans from the point of view of a private insurance company unless you are going to get premiums from a large group of people, including many who are not underfunded. So that if you move over to an exposure or risk related system, it may be that without a lot of control over assets and other things, that you are going to get into an extremely high premium for that group of companies which are the ones who are going to have the fire in the house. You know in advance that their house is going to burn down or may and, therefore, the risk for that group of people is substantially higher. There is no question about it.

Now, if you have them pay a higher premium, it is obviously going to be disproportionately high, and there are going to be some small as well as large employers who are going to be involved. My overall point is that you have a basis for a present premium structure that keeps it at a reasonable level because we are spreading it over a whole group of people. Congress, as I understand it, has decided that that is a social desirability that should be borne by all people. Now, that does not say that we are not looking at it. We are looking at it very carefully.

We have a study going on and I have a personal interest in this for reasons that you have expressed, but I am not sure that the answer is going to be that it is viable. But that study is presently underway and I cannot give you an exact time because it is really

a very difficult problem to grapple with and come up with something when we have the responsibility.

Senator NICKLES. I am aware it is a difficult problem and I was not throwing it out lightly. Other people will testify today calling for some type of co-insurance provision which most private insurance companies, pay 100 percent of a certain benefit and a fixed ratio, 80/20 beyond a certain benefit; beyond that PBGC pays so much a month?

Mr. JONES. \$1,380.68 a month.

Senator NICKLES. \$1,380.68 is the 100 percent per month. That is the basic benefit?

Mr. JONES. The basic benefit, yes.

Senator NICKLES. Which can increase or what?

Mr. JONES. No. It increases with cost of living, the social security contribution base. It is \$1,380.68 for people who come in after the last increase became effective. So it does not retroactively go back and bump everybody up if they came in at a different level.

Senator NICKLES. If they had an entering system where they had say a guaranteed COLA, but they do not receive that COLA, is that correct?

Mr. JONES. Yes, that is correct.

Senator NICKLES. But that is the basic benefit.

Now, what comprises the basic benefits?

Mr. JONES. Well, that is a subject that Congress did not make clear. Congress referred to basic and nonbasic benefits in four or five different sections of ERISA, Senator. It came out with a definition that a basic benefit is anything that a nonbasic benefit is not; that leaves you a pretty wide range as to what a basic benefit is.

Now, in order to get at a basic benefit, one has to address the legislative history and that has been addressed carefully in the past by the PBGC. I have been active in this practice for a number of years and I recall when it came out, back in 1975, I believe, and it came out after there had been proposed regulations on it, and a lot of comments were received. I did not know at that time, but I do know now that I have inquired more fully, that we the PBGC got at that time the advice of outside counsel, of a well-recognized attorney in the area, I believe a professor at Georgetown, Roy Schotlin. The legal conclusion that was reached after reviewing the past history—and after considering all the comments that were then made, was that this is the correct reflection of the intent of Congress at that time as best it could be gathered by the use of such words as retirement benefits or their equivalent or things that are “essentially equivalent.”

Now, it is that interpretation of those words which are at the heart of this problem.

Now, if there was an intent of Congress to produce basic benefits, and if basic benefits were—if essentially equivalent benefits, including some early retirement benefits, let us say, are within the essentially equivalent area of disparity or of the range that you can move in, why then you come out with the right conclusion. I would be the first to admit that I think that the interpretation reached by the PBGC is a matter of judgment. It seems to me that that judgment was reached after regulations were proposed, everybody had a chance to comment on them in 1975. Now, if that matter is going

to be clarified, it would seem to me that Congress perhaps has to address that very problem.

Senator NICKLES. I question whether or not we do, but I question, I think that we will if you do not. And you might be able to give us some information to do that.

But I do not think it was Congress' intent to include early retirement supplements or plant closing benefits as a basic retirement benefit. I think that is misinterpretation by the PBGC's past administration, and I would like a clarification of it from you.

I would also like an estimate of how much that comprises other costs; how many plans now or in the future have that in as a cost, and I am not looking for volumes of actuarial studies and whatnot, but I would like to have some kind of a feel for it. Here again I do not want to inundate the actuaries with tons and tons of work, but I do not think that was Congress' intent, and now we see the premiums on an escalating role. I think we need reforms and some of that reform would be to eliminate the riders that have been added to basic retirement benefits. Let us get back to what Congress was trying to do. I am not sure that it requires congressional action, and we will visit with you further on that.

I personally think a lot of that can be done administratively. If it requires congressional action, we may endeavor to make whatever steps are necessary to correct it. I mentioned plant closing supplements or benefits and I also mentioned early retirement benefits. Is there anything else included in basic benefits now that would not be, what I would say, in the industry norm of basic benefits?

Mr. JONES. Well, I would ask—I think it is primarily in the early retirement benefit but perhaps Gerry Cole or Henry Rose, who are intimately involved with the development of the 1975 regulations would care to comment on that.

Gerry, do you want to speak to that point?

Mr. COLE. The dispute is primarily over subsidized early retirement benefits. Those are retirement benefits which are not actuarially reduced. We do guarantee benefits that are in pay status at termination. One might want to say that such benefits are not basic benefits, but where the participant has already entered pay status, I think the determination is that at that point in time the benefits did become a basic benefit. And the same in time with respect to certain types of widows' benefits, where the widow had entered into pay status. The participants had died prior to the date of termination.

Senator NICKLES. Can you come up with some figures to give us an idea of what kind of percentage we are talking about?

Mr. JONES. I have asked about that myself, Senator, and I have been advised that that figure is not presently within our capability. Whether we can or not, I do not know. I will certainly look into it further at your request.

John, do you want to comment on that figure?

Mr. HIRSCHMANN. I believe I cannot answer that.

Senator NICKLES. This committee will work with you and see what can be done administratively or legislatively if necessary.

I have many other questions I would like to ask, and I realize you have been sitting in that chair for what, a week now?

Mr. JONES. Yes, just about a week. However, I did have the benefit of being a consultant for a few days beforehand.

Senator NICKLES. Let me congratulate you to some extent because it is not an easy position; I think it is one of the more difficult positions to fill in Government. I appreciate your statements before the committee today and, as I stated before, you have our commitment to work with you.

Mr. JONES. Thank you, Senator, very much.

Senator NICKLES. Our next witness today is Richard O'Brien from the ERISA Industry Committee. He is also assistant treasurer of General Motors from New York, and is accompanied by George J. Pantos.

Mr. O'Brien, welcome. I just looked up and noticed that we have some bells ringing and I have 7 minutes to get to the floor. I do not know what the status of that is. It is my hope to be back here at 10 after, in order to continue. We will recess for approximately 10 minutes if that is acceptable. I apologize for the inconvenience.

We will stand in recess.

[Short recess.]

Senator NICKLES. I apologize again, Mr. O'Brien, for the necessity of making that vote and delaying our proceedings here.

I would encourage all of our witnesses to abbreviate their comments, if possible, to allow us a chance to ask questions.

Please proceed.

STATEMENT OF RICHARD O'BRIEN, ASSISTANT TREASURER OF GENERAL MOTORS CORP., NEW YORK, N.Y., ON BEHALF OF THE ERISA INDUSTRY COMMITTEE (ERIC); ACCOMPANIED BY GEORGE J. PANTOS, ESQ., VEDDER, PRICE, KAUFMAN, KAMM-HOLZ & DAY, COUNSEL TO ERIC

Mr. O'BRIEN. Fine, Senator.

I will, if I could, submit the full statement for the record, and then try to highlight the major provisions of my testimony.

After much discussion and also quite a bit of controversy, the idea of a pension benefit guaranty system came to fruition with the passage of ERISA in 1974. Specifically, title IV of ERISA—

Senator NICKLES. Could I get you to pull your microphone up so that we could hear your remarks better?

Mr. O'BRIEN. Specifically, title IV of ERISA established the Pension Benefit Guaranty Corporation (PBGC), a nonprofit corporation whose purpose is: One, to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants; two, to assure the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which the title applies, and three, to maintain premiums established by the Corporation in accordance with the statute at the lowest level consistent with carrying out its obligations under law.

The proposal to increase premiums to \$6 for the single employer pension plan termination insurance program raises the question of whether premiums are, in fact, being contained at the lowest level. ERIC has a substantial interest in the level of premiums since major plan sponsors, such as those represented in ERIC, pay 85 percent of all premiums collected.

However, more important than the issue of the level of the premium are problems involving the basic structure of the single-employer plan termination insurance program. When, in late 1977, a proposal was made to increase premiums from the original \$1 level to the present \$2.60 level, fundamental design problems were only beginning to surface.

The present situation is dramatically different. Substantial problems with the design of the single-employer program have been identified, by the PBGC and by much of the employer community. Accordingly, it would be inappropriate to give attention only to a premium increase, while at the same time ignoring the corresponding problems of the single-employer program.

What are these fundamental design problems? First, there is a significant potential for abuse of the insurance system as the system is currently structured, as you mentioned, and as Mr. Jones mentioned.

Second, we are very concerned about structural defects with respect to both the level and scope of benefits guaranteed by the PBGC. And we are particularly concerned about the effect of abuse. While we are concerned about those problems, we are also concerned about the proposed 130-percent increase in the premium rate.

The present single-employer insurance program requires that a sponsor who terminates his defined-benefit plan must thereupon pay in a single sum any unfunded liability for guaranteed benefits, and turn over the plan to the PBGC to administer the plan's assets thereafter. This requirement has three significant problems:

First, the single sum form of payment is too severe in some cases, since the deficiency will not be needed to pay benefits for many years;

Second, the single sum payment is not enough in other cases, since it is limited to 30 percent of the net worth; and

Third, the PBGC is introduced into every plan termination, even though the plan is already sufficiently funded in 98 percent of the terminations.

ERIC has supported for the last 2 years efforts to remedy the deficiencies of the title IV program. Much of our proposal is contained in S. 1541, sponsored by yourself. S. 1541 resolves the problems outlined by eliminating 30 percent of net worth limit on liability; by allowing the sponsor to continue its association with the plan until all vested benefits are fully funded, in no more than 15 years; and by postponing the PBGC's active involvement until the sponsor is in bankruptcy or liquidation. This approach plugs the loophole through which several large employers have escaped within the past 2 years, paying 30 percent of a small net worth and dumping a large remaining unfunded liability onto the insurance system.

ERIC believes that there are elements of the current structure of the plan termination insurance program which can only lead to continuing cost pressures on the system. These cost pressures have resulted from both design flaws in the system, and also an unwarranted extension of PBGC coverage. Accordingly, ERIC proposes that before any increase in premium is considered, the current

level and scope of guaranteed benefits should be carefully examined.

The guarantee of 100 percent of the vested benefit up to the current maximum level of \$1,381 per month essentially represents a complete guarantee of pension benefits. ERIC does not believe that it was the intent of ERISA to provide total coverage to all plan participants, but to provide a fair level of protection of retirement income.

Cost-sharing among all parties to an insurance agreement is a well-established and long-accepted principle. In almost any example of an insurance program available in this country, there is some element of cost-sharing by the insured party, be it through a copayment provision or limitation and benefits payable. Health, general casualty, hospitalization, and auto insurance all provide for some degree of coinsurance. But the PBGC guarantees have no similar provision. Some cost-sharing arrangement would constitute better plan design.

As an alternative to the current formula, the level of guaranteed benefits could be limited to an amount determined according to the years of covered service of the plan participant. For example, the guaranteed benefit could be determined, as in the case of multiemployer plans, as 100 percent of the first \$5 of monthly benefit per year of service plus 75 percent of the next \$15 of monthly benefit per year of service. Such a formula would introduce some coinsurance for lower paid participants, with a relatively larger coinsurance element for higher paid participants.

Defining the level of the benefit guaranteed, as in the above example, has the additional effect of lessening the disparity of insurance coverage afforded under different plans. When in essence, fully vested benefits are guaranteed, the level of insurance coverage is based on the level of benefits provided under the plan. While higher plan benefit levels would generally indicate a somewhat greater potential liability for the PBGC, the related premiums remain at a flat rate regardless of benefit level.

Also to be carefully reviewed is the definition of benefits guaranteed by the PBGC. It is ERIC's position, consistent with the original intent under ERISA, that the benefit to be guaranteed should be the normal retirement benefit or its actuarial equivalent. ERIC believes that the extension, by regulation, of the definition of guaranteed benefits to include early retirement supplemental, plant closing, and other nonbasic benefits has added significantly to the financial problem the PBGC is facing. However, it is our understanding, as was mentioned this morning, that the PBGC itself is unable to determine the cost-effect of guaranteeing such extended benefits. ERIC would suggest that Congress direct, in examining this premium increase request, that, as a minimum, the PBGC be required to collect and make available data on the cost impact of guaranteeing benefits beyond the normal benefit, or its actuarial equivalent.

Even in the absence of empirical data, there is little doubt that significant expansion of the scope of guaranteed benefits is costly. When ERISA was passed, a specific distinction in the law between the basic benefits designated as guaranteed and those other classes

of benefits that the PBGC was authorized to separately guarantee was made.

It should be noted also that the expansion of the scope of guaranteed benefits can have an impact not only on the PBGC premiums, but upon plan sponsor funding as well. For example, in the auto industry, certain early retirement supplements are provided to employees who retire early with 30 years of service. These pension supplements, which are forfeitable in certain circumstances, were never intended by either the employers or the unions with which the benefits were negotiated to be prefunded and would generally not be payable in the event of plan termination. However, since these types of benefits can be guaranteed by the PBGC, the IRS has required that they be funded under the ERISA minimum funding standards. For General Motors alone, the additional cost of this prefunding requirement amounts to about \$90 million per year.

If GM were to go out of business, for example, we would not want to have that liability to be thrown on the rest of the employer community. So if the benefits are guaranteed, they would have to be funded.

Basically we do not have a quarrel with that. We have a quarrel with the requirement that the benefits could be guaranteed by the PBGC, and this requirement means that if we are required to fund these benefits as we currently are under the ERISA minimum funding standard, it results for General Motors alone, in a \$90 million per year cost, over and above what was intended by either General Motors or the UAW, with which these benefits were negotiated. That \$90 million a year will translate to assets of over \$2 billion ultimately, that we believe were not intended by either party to be put into a pension fund for purposes of prefunding these early retirement supplements, and we believe this money could be better utilized in a business that is already capital constrained.

Next, I would like to turn to the basis of the requested premium increase. The PBGC has separated its premium requirements into four distinct categories. Without suggesting an order of importance, these categories are:

First, a provision for contingencies;

Second, administrative expenses;

Third, the cost of amortizing current unfunded claim liabilities; and

Fourth, the projected level of annual claims in future years.

Provision for contingencies—ERIC understands that PBGC has stated that no provision for contingency reserves has been explicitly included in this latest request. We feel that, as a policy, this is appropriate given the stability of the base of premium payers and the mandatory nature of the program.

As the PBGC has noted this morning, they have no contingency for the reserves, and we feel that is appropriate, given the base of the payers and the mandatory nature of the program.

The level of administrative expenses is also not a major point of contention, although we believe that the administrative expenses borne by the PBGC should not cover sufficient plans, that there should be no obligation of the PBGC to take on the administrative

cost of sufficient plans—that should be left to the sufficient plans themselves, and you have responded to that in your legislation.

With respect to amortization of current unfunded claim liabilities, a portion of the current \$2.60 premium is intended to amortize past claims in excess of premium income. However, as in 1977, when the last premium increase was being discussed, the period over which losses were to be amortized was approximately 10 years, rather than the 5-year period underlying the current premium request. They amount to \$189 million. It was expected that this would increase to \$236 million next year.

To some degree that implies a degree of precision with respect to these numbers, but I would mention at the end of fiscal year 1979 the unfunded liability was \$146 million, at the end of fiscal year 1980 it dropped to \$94 million, and at the end of fiscal year 1981 it doubled to \$189 million.

So basically, while there may be some degree of precision with respect to the way in which the liabilities were developed, certainly the past history would indicate that the liabilities can vary significantly from year to year, and what we are faced with is a period in which the liabilities have reached the peak of \$189 million, double last year, and what is being proposed is that the liabilities be funded over half the period of time, 5 years versus the 10-year period that the PBGC initially indicated in 1977 that these liabilities should be funded.

Senator NICKLES. Could we move faster?

Mr. O'BRIEN. Sure, I am sorry.

Finally, half the PBGC request relates to future claims—and to project these claims, the PBGC has utilized past experience and a projection of that past experience going forward. We would question the use of trend line projections on the basis that such a trend line projection relies generally on two important principles.

The existence of a large body of data, and two, the ability to exclude significant aberrations. We have some problems in the way in which these trend lines were calculated, and basically it projects a trend off of the past 2 years of experience, which for the country generally has been a period of general recession.

I do not think that we would, in any other projections, project that next year we would have a recession that would increase by 8 percent, and going forward would increase by 8 percent a year. The same is true of these sort of projections.

Senator NICKLES. I would like to ask you a few questions, if I could interject at this time, because I read your statement concerning the amount of the premium increase, and how much possibly is used in different assumptions.

Mr. O'Brien, you are Assistant Treasurer of General Motors?

Mr. O'BRIEN. Yes, sir.

Senator NICKLES. In New York?

Mr. O'BRIEN. Right.

Senator NICKLES. In your negotiations, is one thing as far as now, you are required to do is meet minimum funding standards for your "early retirement provisions"?

Mr. O'BRIEN. That is correct.

Senator NICKLES. Do you have a 30 year and out in your plan?

Mr. O'BRIEN. That is correct. Essentially these benefits first began in 1964, and I might just go back to 1950, when the UAW-GM pension plans were put into effect. We had at that time a 30 year funding requirement, which is now equal to ERISA's funding requirement.

So we always had a funding requirement with respect to regular pension benefits payable at normal retirement, a 30-year funding requirement.

In 1964, we began in the Chrysler negotiations with these early retirement supplements, and they were further expanded in the 1970 negotiations, and in 1973, so that ultimately now an employee in the auto industry can retire at any age, with 30 years of service, and receive a benefit of \$935 a month.

Now, that benefit consists of a basic pension benefit which is reduced by age, for age earlier than age 62. So if normal retirement benefits, for example, were \$450 a month, a person retiring early may only be entitled to a basic benefit equal to the actuarially reduced amount of that, which may be about half of that, or \$225 a month.

Now, the early retirement supplement is an amount sufficient to raise that to \$935 a month. The supplements are not part of the ERISA vesting standards, or the accrual standards. If an employee goes out in a job and earns more than \$6,000, that supplemental benefit is reduced \$2 for every \$1 that the employee makes. So there is a substantial forfeiture in the event an employee goes out and gets another job.

So basically our view is that these benefits should not be a part of the funding standards, since they are not a part of the vesting or accrual standards, they are forfeitable to a certain extent, and the parties which negotiated this benefit were fully aware that they need not be prefunded.

Since the provision in 1964, we have had a requirement that the fund balance be no less than zero. An employer can choose to fund more if he wants to, but that was the basic agreement.

Senator NICKLES. For the early retirement supplement?

Mr. O'BRIEN. Yes, sir.

Senator NICKLES. Do you believe that the early retirement supplement should not be insured by PBGC?

Mr. O'BRIEN. Yes, I do. It was never intended, in the event of our plan's termination, that these benefits be paid. Since the inception of our pension plan, since the inception of these early retirement supplements, we had a provision in the plan that in the event of termination these benefits would not be paid.

So it was the intention of neither party to the agreement that the benefits would be promised in the event of plant termination, and we are not saying that the rest of the employer community should pick up that benefit. We are saying that it should not be paid.

We have gotten basically, in the 1982 agreement, with the UAW, a letter agreement to look at the possibility of removing these early retirement supplements from the pension plan, for the purpose of considering alternate funding methods with respect to these benefits.

I think from the union standpoint, they are basically looking at this additional funding requirement as eating into other wages and benefits; from the company's standpoint we are looking at it as eating into our capital requirements which, as you know, the industry is undergoing a capital intensive period.

Senator NICKLES. As far as the renegotiations that have come about this year, are there any major significant changes in respect to pensions?

Mr. O'BRIEN. No, sir. Basically the pension benefits had been frozen through the end of the agreement. The only changes that we made in the benefits were an increase in the temporary benefits, which is payable prior to age 62, from \$375 a month maximum to a \$450 a month. That provision applies in only 2 percent of our retirements. It is applicable only to a company concent type of retirement, and not voluntary retirement, and 98 percent of our retirements are voluntary.

So the impact of pension negotiations were a very small part of the total cost of the settlement, less than 5 cents an hour.

Senator NICKLES. Did you pass plant closing agreements in the 1982 agreements?

Mr. O'BRIEN. Yes, we did.

Senator NICKLES. Do you think those should be covered by PBGC?

Mr. O'BRIEN. No. And again, I think that these types of benefits, the plant closing provisions, were to some degree, responsive to concerns of both parties in the renegotiations; from a company standpoint, it was in recognition of the forgoing of wage increases and further benefit increases.

From the union's standpoint, it insured job security for their members, or at least that they would be paid in the event that they did not have a job.

Some of these benefits are payable at up to 75 percent of pay for life. I would not propose that these benefits—and I do not think they were intended by the parties, to be guaranteed by the PBGC.

Senator NICKLES. Under current administrative rulings by PBGC, they would in most cases include that as "A basic benefit that should be insured by PBGC"?

Mr. O'BRIEN. Senator, these are relatively new benefits, and I am not sure how the PBGC would treat the plant closing benefits, the so-called guaranteed income stream benefits. I would hope that they would not be a part of the guaranteed benefits.

Senator NICKLES. Do pension plans sponsored by ERIC members frequently promise benefits beyond normal retirement age of 65?

Mr. O'BRIEN. Normally we provide for benefits beyond the normal age 65 benefits. Most ERIC plans provide for early retirement benefits in some cases mutually satisfactory retirement benefits, at age 60; I think that is fairly common among the ERIC plans. Many employers provide for social security makeup benefits that are payable prior to age 62, in the event of early retirement. So they do provide for benefits beyond the normal retirement benefits.

Senator NICKLES. Regardless, if a person elects early retirement, or post-retirement, is it your belief that PBGC's benefits should be

the actuarial benefits of their normal retirement, age 65 retirement amount?

Mr. O'BRIEN. Yes, we do. It is our basic position that it was the intent of ERISA to provide for vesting standards under which employers' benefits would be promised to the employee, and so employees would have some assurance that the payment would be made, to insure that the employer backed up that pension promise by providing for funding. Many of these early retirement benefits are not a part of the ERISA vesting standards. The social security makeup benefits, and the supplements paid prior to age 62 were not a part of the ERISA vesting, or accrual standards, although many employers fund those benefits.

Senator NICKLES. You do not think they should be a part of that basic benefit?

Mr. O'BRIEN. No, sir.

[The prepared statement of Mr. O'Brien follows:]

STATEMENT OF
THE ERISA INDUSTRY COMMITTEE (ERIC)
TO THE
SUBCOMMITTEE ON LABOR
OF THE
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
REGARDING
THE PROPOSED INCREASE IN SINGLE EMPLOYER
PLAN TERMINATION INSURANCE PREMIUM
MAY 19, 1982

My name is Richard O'Brien, Assistant Treasurer of General Motors Corporation. I am here on behalf of the ERISA Industry Committee (ERIC) and I am accompanied by George J. Pantos of Vedder, Price, Kaufman, Kammholz & Day, counsel to ERIC.

ERIC is an association of 112 major corporations concerned with national retirement policy issues. ERIC's members include half of the nation's fifty largest industrial companies and represent a broad cross section of the nation's largest retailers, utilities, bankers and insurers.

After much discussion and also quite a bit of controversy, the idea of a pension benefit guaranty system came to fruition with the passage of ERISA in 1974. Specifically, Title IV of ERISA established the Pension Benefit Guaranty Corporation (PBGC), a non-profit corporation whose purpose is

- (1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,
- (2) to assure the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which the title applies, and
- (3) to maintain premiums established by the corporation in accordance with the statute at the lowest level consistent with carrying out its obligations under law.

The proposal to increase premiums to \$6.00 for the single employer pension plan termination insurance program raises the question of whether premiums are, in fact, being contained at the "lowest level." ERIC has a substantial interest in the level of premiums since major plan sponsors, such as those represented in ERIC, pay 85% of all premiums collected. However, more important than the issue of the level of the premium are problems involving the basic structure of the single-employer plan termination insurance program. When, in late 1977, a proposal was made to increase premiums from the original \$1 level to the present \$2.60 level, fundamental design problems were only beginning to surface. Accordingly, neither the Congress, the administering agency, or the community of plan sponsors were able to effectively suggest solutions to those problems. In particular, the employer community supported the proposal to increase premiums to the level required for the program.

The present situation is dramatically different. Substantial problems with the design of the single-employer program have been identified, by the PBGC and by much of the employer community. Accordingly, it would be inappropriate to give attention only to a premium increase, while at the same time ignoring the corresponding problems of the single-employer program.

What are these fundamental design problems? First, there is a significant potential for abuse of the insurance system as the system is currently structured. Second, we are very concerned about structural defects with respect to both the level and scope of benefits guaranteed by the PBGC.

With respect to the potential for abuse, legislation is required which would prevent employers from "dumping" unfunded pension liabilities on the PBGC and, therefore, on the premium paying population. We strongly believe that certain provisions of S.1541, the Retirement Income Incentives and Administration Simplifications Act of 1981, would plug loopholes which exist in the current law and would prevent such abuse.

Regarding PBGC guaranteed benefits, the current scope and level of such benefits should be carefully reviewed. The level of guaranteed benefits provided under the program may be excessive. As a practical matter, except for the phase-in of benefit increases over the five-year period preceding plan termination,

100% of the nonforfeitable pension plan benefit is guaranteed by the insurance system. It should be noted that even the phase-in is sometimes rendered moot by the \$20 minimum provisions under current law. In addition, since 1974, the scope of these guaranteed benefits has been significantly expanded by the PBGC through regulation.

These fundamental design problems have, we believe, resulted in a greater than necessary burden on premium payers. A five-fold increase in the premium requirement over a period of less than 8 years is truly significant and merits inspection. Continued skyrocketing of insurance premiums could threaten the viability of the insurance system and could actually discourage, rather than encourage, the continuation and maintenance of voluntary private pension plans.

While we are particularly concerned with the effect of abuse of the insurance system and other structural defects of the single-employer program, we are also concerned that the proposed 130% increase in the premium rate is based upon certain suspect assumptions and methodology. More details in this regard follow later in this statement.

Abuse of the Insurance System

The present single-employer insurance program requires that a sponsor who terminates his defined-benefit plan must thereupon pay in a single sum any unfunded liability for guaranteed

benefits, and turn over the plan to the PBGC to administer the plan's assets thereafter. This requirement has three significant problems:

- (1) the single sum form of payment is too severe in some cases, since the deficiency will not be needed to pay benefits for many years,
- (2) the single sum payment is not enough in other cases, since it is limited to 30% of the net worth, and
- (3) the PBGC is introduced into every plan termination, even though the plan is already sufficiently funded in 98% of the terminations.

ERIC has supported for the last two years efforts to remedy the deficiencies of the Title IV program. Much of our proposal is contained in S.1541, sponsored by Senator Nickles. S.1541 resolves the problems outlined by eliminating the 30% of net worth limit on liability; by allowing the sponsor to continue its association with the plan until all vested benefits are fully funded, in no more than 15 years; and by postponing the PBGC's active involvement until the sponsor is in bankruptcy or liquidation. This approach plugs the loophole through which several large employers have escaped within the past two years, paying 30% of a small net worth and dumping a large remaining unfunded liability onto the insurance system, while continuing to prosper in business and even operating a new pension plan that provides future benefits at the same level as the former terminated plan.

S.1541 further provides a reasonable interval over which the continuing employer can complete his funding. And, it avoids the unnecessary administrative expenses associated with inserting the PBGC into every plan termination, even though only 2% are insufficiently funded, and some of those 2% are healthy companies. ERIC therefore heartily endorses this approach.

While we do not support all provisions of S.1541 as currently drafted, we do not believe that any premium increase should be considered by Congress except as a component of a plan to correct the major Title IV deficiencies in ERISA that have been identified, and preferably with other changes to assure a sounder and stronger private pension system for our nation.

Level and Scope of Guaranteed Benefits

ERIC believes that there are elements of the current structure of the plan termination insurance program which can only lead to continuing cost pressures on the system. These cost pressures have resulted from both design flaws in the system, and also an unwarranted extension of PBGC coverage. Accordingly, ERIC proposes that before any increase in premium is considered, the current level and scope of guaranteed benefits should be carefully examined. Limitations in the level and scope of guaranteed benefits would improve insurance program design.

A. Level of Guaranteed Benefits

The guarantee of 100% of the vested benefit up to the current maximum level of \$1,381 per month essentially represents a complete guarantee of pension benefits. ERIC does not believe that it was the intent of ERISA to provide total coverage to all plan participants, but to provide a fair level of protection of retirement income. Limitation of the level of guaranteed benefits by means of coinsurance would be far more desirable, from a program design standpoint, than the current structure whereby the entire burden of guaranteeing benefits under terminated plans is borne by the remaining plan sponsors through higher premiums. Covered employees should have no less an interest than participating plan sponsors in the sound funding and provision of pension benefits. This is accomplished through risk-sharing. It should be noted here that risk-sharing by employees is equitable in that the overwhelming majority of situations in which the PBGC must guarantee benefits result not from situations involving mismanagement of pension funds, where there would be a stronger case for the liability to be borne solely by the employer group (since it is the employer group which is responsible for investing plan assets), but from the failure of plan sponsors as a result of systemic factors which affect the economy and business, in which employees as well as employers are participants.

Cost-sharing among all parties to an insurance arrangement is a well-established and long-accepted principle. In almost any

example of an insurance program available in this country, there is some element of cost-sharing by the insured party, be it through a copayment provision or limitation on benefits payable. Health,^{1/} general casualty, hospitalization and auto insurance all provide for some degree of coinsurance. But the PBGC guarantees have no similar provision. Some cost-sharing arrangement would constitute better plan design. For example, initial hospitalization benefits are usually covered or reimbursed up to 100% and beyond some limit (generally based on a number of days coverage), benefits are covered by major medical at a percentage, usually from 70% to 80%, of the total cost, with the insured party paying the remainder. ERIC believes adoption of a cost-sharing arrangement could significantly alleviate the escalating cost pressures facing the PBGC.

As an alternative to the current formula, the level of guaranteed benefits could be limited to an amount determined according to the years of covered service of the plan participant. For example, the guaranteed benefit could be determined, as in the case of multiemployer plans, as 100% of the first \$5 of monthly benefit per year of service plus 75% of the next \$15 of monthly benefit per year of service. Such a formula would introduce some coinsurance for lower paid participants, with a relatively larger coinsurance element for higher paid participants. Consider, for

^{1/} Indeed, the trend in reduction of cost-sharing in the area of health insurance has probably impaired the ability to contain health care costs.

example, a lower paid employee who after 20 years of service would otherwise be entitled to a vested benefit of \$150 per month, equivalent to an accrual rate of \$7.50 per year. Under the above guarantee formula, such employee would have a guaranteed benefit of \$137.50 per month, or 91.7% of his vested benefit. For an employee with a vested benefit of \$300 per month after 20 years, accrued at a rate of \$15 per year, the guaranteed benefit would be \$250 per month, or 83.3% of the vested benefit. And, for an employee with a vested benefit of \$500 per month after 20 years (accrued at \$25 per year), the guarantee would be \$325, or 65% of the vested benefit. As can be seen, this arrangement continues to provide extensive protection for those employees at the lower end of the benefit spectrum with a progressively increasing level of risk-sharing moving toward the high end, where employees may be expected to have greater resources to shoulder such risk.

Defining the level of the benefit guaranteed, as in the above example, has the additional effect of lessening the disparity of insurance coverage afforded under different plans. When in essence, fully vested benefits are guaranteed, the level of insurance coverage is based on the level of benefits provided under the plan. While higher plan benefit levels would generally indicate a somewhat greater potential liability for the PBGC, the related premiums remain at a flat rate regardless of benefit level. The above formula for guaranteed benefits would thus

provide that the level of coverage would be more closely related to the structure of premiums.

Another alternative which should be considered is defining the guaranteed benefit as some percentage (less than 100%) of the vested benefit. This approach also has the advantage that coinsurance is a feature. In addition, it provides a certain indexing for guaranteed benefits as opposed to the previously cited formula under which the dollar amounts of coverage at 100% and at 75% were fixed (although these amounts could be indexed if desired). A disadvantage of this approach is that the level of coverage is different between plans.

B. Scope of Guaranteed Benefits

Also to be carefully reviewed is the definition of benefits guaranteed by the PBGC. It is ERIC's position, consistent with the original intent under ERISA, that the benefit to be guaranteed should be the normal retirement benefit or its actuarial equivalent. ERIC believes that the extension, by regulation, of the definition of guaranteed benefits to include early retirement supplemental, plant closing, and other non-basic benefits has added significantly to the financial problem the PBGC is facing. However, it is our understanding that the PBGC itself is unable to determine the cost effect of guaranteeing such extended benefits. ERIC would suggest that Congress direct, in examining this premium increase request, that, as a minimum, the PBGC be required to collect and make available data on the cost impact of

guaranteeing benefits beyond the normal benefit (or its actuarial equivalent).

Even in the absence of empirical data, there is little doubt that significant expansion of the scope of guaranteed benefits is costly. When ERISA was passed, a specific distinction in the law between the basic benefits designated as guaranteed and those other classes of benefits that the PBGC was authorized to separately guarantee was made. ERIC feels this distinction has effectively been erased by the expansion of guaranteed benefits through PBGC regulations. In fact, no non-basic benefit guaranty program has ever been established or even proposed by the PBGC. As a result, employers have had to pay premiums for guarantees of benefits that they frequently do not even provide for their own employees. By expanding the scope of guaranteed benefits, those participants with basic nonforfeitable (or vested) benefits could be disadvantaged, to the extent non-basic benefits are elevated from a subordinated position to compete with the prior vested benefits with respect to the allocation of plan assets.

Again, this expansion of the basic benefit engenders a similar problem as is evident when there is no coinsurance provision in the program -- that there is a tremendous disparity among plans -- and therefore plan participants -- as to coverage, depending on the types of benefits provided under the individual plans.

It should be noted also that the expansion of the scope of guaranteed benefits can have an impact not only on the PBGC premiums, but upon plan sponsor funding as well. For example, in the auto industry, certain early retirement supplements are provided to employees who retire early with 30 years of service. These pension supplements, which are forfeitable in certain circumstances, were never intended by either the employers or the unions with which the benefits were negotiated to be prefunded and would generally not be payable in the event of plan termination. However, since these types of benefits can be guaranteed by the PBGC, the IRS has required that they be funded under the ERISA minimum funding standards. For General Motors alone, the additional cost of this prefunding requirement amounts to about \$90 million per year.

C. A Possible Alternative

Additionally, there is a possible alternative relating to the maximum benefit guaranteed by the PBGC to alleviate the ongoing pressure on the PBGC premium rate. However, it should be clear that this alternative would not solve the fundamental design problems which are in need of being rectified.

Clearly, the setting of a limit on benefits was indicative of Congress' intent in this area, yet this intent has not been effectively carried out. The combined effect of the setting of the initial level and its escalation due to inflation have rendered the guarantee limitation virtually powerless. Due to

inflation adjustments, the current maximum guaranteed benefit is \$1,381 per month.

In the extreme case of an individual with 40 years of covered service under a flat dollar pension plan, this represents a benefit accrual of about \$34.50 per month per year of service. This is in excess of the benefit accruals provided for under almost all pension plans in industry today and, of course, few participants reach 40 years of service. For a similarly situated individual covered under a pay-related plan, providing say 1% of final 5-year salary per year of service, an individual's salary would have to exceed \$45,000 per year in order for the maximum benefit limitation to have any effect on the guaranteed normal retirement benefit. Relatively few individuals are at this salary level. Thus, the guarantee limitation has no real effect.

As a minimum, Congress should consider a freeze on the maximum guaranteed benefit at its current level. Over time, the maximum limitation will become effective on a phase-in basis, and eventually provide meaningful cost control.

Basis of the Requested Premium Increase

As part of our comment on the proposed PBGC premium increase, we would like (for the moment) to focus our attention on the past and current operation of the plan termination insurance program under Title IV of ERISA. Although a detailed philosophy of premium requests has not been articulated by the PBGC, it

would seem that this latest request represents a marked departure from guidelines used to formulate the 1977 request for an increase.

The PBGC has separated its premium requirements into four distinct categories. Without suggesting an order of importance, these categories are:

- (1) a provision for contingencies,
- (2) administrative expenses,
- (3) the cost of amortizing current unfunded claim liabilities, and
- (4) the projected level of annual claims in future years.

(1) Provision for Contingencies

ERIC understands that PBGC has stated that no provision for contingency reserves has been explicitly included in this latest request. We feel that, as a policy, this is appropriate given the stability of the base of premium payers and the mandatory nature of the program.

(2) Administrative Expenses

The level of administrative expenses is not a major contention, although ERIC notes that the current request indicates that administrative expenses are now at a level which was initially felt would be sufficient

to fund the entire termination insurance program when it was first established.

(3) Amortization of Current Unfunded Claim Liabilities

A portion of the current \$2.60 premium is intended to amortize past claims in excess of premium income. However, as of 1977, when the last premium increase was being discussed, the period over which losses were to be amortized was approximately 10 years, rather than the 5-year period underlying the current premium request. The 10-year period established in 1977 was purported to represent PBGC's estimate of the "dollar weighted" deferral period for those pension obligations for which it was to make payments. Now the PBGC is requesting that the amortization period be cut in half. It appears that there has been a major shift in philosophy for amortizing unfunded claims from 10 to 5 years without accompanying justification.

The 5-year amortization cost reflects almost \$2.00 of the \$6.00 requested. More than one-third of this \$2.00 is attributable to the shift from a 10-year to a 5-year amortization period. ERIC does not feel that a 5-year amortization period is justifiable. Prior to ERISA, the shortest period over which private plan sponsors could amortize unfunded obligations was approximately 12 years. Even ERISA only shortened the period to 10 years.

We fail to see the need for a 5-year amortization period, especially in light of the previously mentioned mandatory nature of the program. At the very least, if it is decided that 5 years is the appropriate period, the Congress should schedule a premium decrease of \$2.00 per participant, beginning 5 years after any increase. Once losses are amortized, there should be no further need to collect the amortization component of the premium, since the PBGC has not indicated a need for a contingency reserve.

At this point in our comments relating to the proper premium charge for amortizing unfunded claims, ERIC would like to express frustration in attempting to correlate the various estimates of obligations which the PBGC has reported. Just recently the PBGC released its report for fiscal year 1980. One item of note in that report was a decrease in unfunded claim liabilities of approximately \$50 million during fiscal year 1980. Shortly thereafter, the PBGC indicated the need for a major premium increase. Then, the PBGC released its Annual Report for FY 1981 which showed an increase in the unfunded claim liability of \$94 million (nearly \$60 million of which was due to one very large claim pending at the end of FY 1981). To say the very least, this chronology of circumstances has caused considerable confusion.

Further on this point, the General Accounting Office has expressed its own reservations regarding the financial statements published by the PBGC. Some of ERIC's members have indicated that a reading of a March 1982 report by the PBGC regarding the proposed premium increase creates more confusion than enlightenment with respect to the basis for the premium request. One thing is clear -- the basis of the premium request rests in part on financial reports and information which are subject to substantial questions -- and, therefore, no premium increase can reasonably be put forward on this basis.

(4) Premium Requirement for Future Claims

Half of the premium request, or approximately \$3.00, relates to PBGC's estimate for future claims. For the 1977 premium request, the PBGC attempted to relate the level of claims incurred in any year to some fundamental economic cause. While there are many economic variables which may be strongly correlated to PBGC's claims level, a single variable was selected -- the level of unemployment.

It is our understanding that the PBGC no longer feels that the unemployment rate is a reasonable basis for predicting its future claims. In fact, it no longer feels that any economic model is appropriate for

the projection of claim experience. We would suggest that efforts to secure a correlation between the level of expected losses and economic activity be continued as the PBGC's claim experience matures.

To project claims for the \$6.00 premium request, PBGC has suggested an approach wherein year-by-year experience is (in effect) plotted on a graph, and then some sort of line is drawn through the points. From that line, the PBGC contends that future claims can be extrapolated. While the use of trend line analysis is a common practice in forecasting, the validity of this forecasting tool rests upon two important principles: (1) the existence of a large body of data based on past experience; and (2) the ability to exclude significant statistical aberrations.

The statistical techniques which the PBGC has employed in projecting its future claims are not consistent with these principles. Much of the request for the premium increase is based on the questionable assumption that recent losses attributable to the termination of a single plan at the end of a projection period is a good barometer of the future. Furthermore, the \$6.00 request is based not on the assumption that recent levels of claims will continue into the future, but that the trends in those levels of claims should

set the level of premiums. As a result of the approach taken, the PBGC report projects a continued acceleration in the level of losses incurred each year to levels that become alarming.

ERIC does not believe that a trend analysis is an appropriate tool to use in setting premium levels for future claims. This is because there is a paucity of data and because any trend analysis is dominated by a single large claim recently incurred. The PBGC itself recognized that it was necessary to examine alternative approaches to establish the level of future claims. In fact, one PBGC alternative called for a premium of \$4.70, rather than \$6.00, a reduction of \$1.30 from the recommended rate and nearly one-half of the \$3.00 proposed to cover future claims. A case could be made that even the lowest premium level considered by the PBGC (\$4.70) is unduly influenced by the single large claim. The PBGC has already included this single large claim in the proposed provision for amortizing past losses and it therefore doubly influences the premium request if it is included in the future claim provision as well.

Summary and Conclusions

On the subject of the premium itself, our opinion is that the request is based upon financial results and assumptions which

are questionable and cannot be reasonably relied upon as the basis of a premium increase.

More importantly, however, substantial design problems have been identified under the single-employer plan termination insurance program. Specifically, the opportunity for plan sponsors to abuse the insurance system at the expense of other premium payers needs immediate legislative attention. If not remedied, hemorrhaging of the system is likely, and the prognosis for survival would be poor. In addition, there are certain problems in the area of guaranteed benefits. Significant reexamination of the structure of the basic benefit guaranty program is prescribed to relieve financial pressure on the insurance system. If these steps are not taken, we expect that employers would be further discouraged from continuing and maintaining voluntary private pension plans. That is, the health of the entire system could be jeopardized. Thus, much more critical than the acute problem of a purported need for a premium increase are the systemic ailments we have identified. No premium increase should be considered without addressing these systemic problems. And, if such problems are repaired, PBGC's financial position should improve quite dramatically.

Senator NICKLES. Gentlemen, we very much appreciate your statement before this committee today.

Thank you.

On our next panel we have William Zeigler, director of compensation and benefits for Wilson Foods, Inc., from Oklahoma City, representing the National Employee Benefits Institute; Richard Raskin, vice president, George B. Buck Consulting Actuaries, representing the Association of Private Pension and Welfare Plans; and Edward O. Handy, Jr., vice president, employee benefits, Textron, Inc., representing the National Association of Manufacturers.

Mr. Zeigler, please begin.

STATEMENTS OF WILLIAM H. ZEIGLER, DIRECTOR OF COMPENSATION AND BENEFITS FOR WILSON FOODS, INC., OKLAHOMA CITY, OKLA., ACCOMPANIED BY THOMAS G. SCHENDT, ADMINISTRATOR, NATIONAL EMPLOYEES BENEFITS INSTITUTE, WASHINGTON, D.C.; RICHARD S. RASKIN, VICE PRESIDENT, GEORGE B. BUCK CONSULTING ACTUARIES, INC., NEW YORK, N.Y., ON BEHALF OF PRIVATE PENSION AND WELFARE PLANS, INC.; AND EDWARD O. HANDY, JR., VICE PRESIDENT, EMPLOYEE BENEFITS, TEXTRON, INC., ACCOMPANIED BY PETER TURZA, ESQ., GIBSON, DUNN & CRUTCHER, WASHINGTON, D.C., ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, A PANEL

Mr. ZEIGLER. Thank you, Senator.

I will just paraphrase our written testimony, in the interest of time.

With me is Mr. Thomas Schendt, who is the head of our Washington office. It was formed in 1977. We call it NEBI, for short. It is to provide contact with Washington legislators in the area of employee benefits.

We currently represent about \$25 billion in pension assets. We view the PBGC process as simply reemphasizing time honored approach in Washington, and that is, ask for money now, and resolve the problems later.

We would prefer to see the PBGC take a different approach. We submit that their assets are sufficient so that they can devote some time to a study of what we regard as some of the structural problems inherent in the program, structural problems that have been known from the outset, but which have been pyramiding over this period of 5 to 7 years.

I think, Senator, you have addressed several of these structural problems in your bill, S. 1541, and we support those areas of the bill that address these specific structural problems, and really they have to be addressed in concert, we believe.

Specifically, your bill calls for looking at a liquidation or bankruptcy type condition as opposed to simply a plan determination decision by an employer. It proposes to eliminate the 30 percent of net worth limit on employer liability, and also it would propose to allow employers who terminate plans to continue relationship over something like 15 years. I think that is quite reasonable, considering the fact that plans are funded now over 30 years, which include

both the provision for future service, as well as past service benefits.

So we support those areas of your bill. We believe there are other structural problems which should be addressed, and I would just mention two, and these are really correlated to—that is relating liabilities to premiums, and second, covering only basic benefits.

I think you already had a dialog on those. I think we certainly support the fact that a basic benefit was supposed to be an age 65 benefit, or the actuarial equivalent thereof.

Just to give an example, I think you could have a situation where an employer would have no unfunded benefits, but yet would be paying premiums, and getting nothing in return. His premium could be used to subsidize someone else's early retirement benefits, which as we already discussed may be beyond the basic benefit intended by Congress. It reminds me of a statement that William Bendix used to use years ago in the "Life of Reilly" series, that is, "What a revolting development that is."

Senator NICKLES. What did you say?

Mr. ZEIGLER. William Bendix. I am sorry, that dates me.

Senator NICKLES. What was his quote?

Mr. ZEIGLER. "What a revolting development this is."

So we would submit that there is a revolting development that has taken place with respect to those employers who choose to fund their plans on a sound basis, and who have no funded benefits.

Again, I would simply like to reemphasize the fact that we do support the provisions of your bill that address some of these structural problems. Specifically, those areas of your bill that address these problems would allow—would not allow, rather, an employer to simply call for a plan termination and absolve himself of unvested fund liabilities, actually preferring to cast them on the backs of other employers contributing to the system, and then go merrily on his way, perhaps adopting another pension plan for future benefits only.

And those three provisions of your bill would have to be looked at in concert to resolve that problem. We have other areas of concern, just briefly, the investment portfolio of PBGC, as we understand it, is rather heavily weighted toward long-term Government bonds. The last 2 years, the revolving fund account has had a negative return, and we think that something should be looked at in that regard.

Just to mention some things that are being done in private industry, many companies are looking at immunized bond portfolios, which essentially guarantees a rate of return over a period of time, and even beyond that, I understand, although I am not an investment expert, that there is even dealings in futures on bonds which would allow for some flexibility beyond the immunization period.

Also, other funds are looking, and have invested in guaranteed interest contracts, which pay pretty substantive returns, although perhaps the long time term is not as good as in the bond portfolio type situation.

In general, then, we would suggest that the committee, as part of its responsibilities, ought to look at the investment policies of the corporation. We would even propose this, why not even sell some of

the liabilities to private carriers? I know this is not permitted by ERISA, but I think it is something that should be looked at, because you can get pretty good annuity rates out there in the market today. Probably the PBGC would have to be some standby guarantor in that situation, but in my opinion, if an insurance company, like Prudential, or Metropolitan Life goes under, I doubt that the country is far behind.

We would also have some problems with the assumptions for future and current liabilities, looking specifically at future liabilities in the proposed increase. We understand that about 51 percent, and this is off-the-cuff, about 51 percent of the premium increased for future liabilities, it has problems in giving any concrete validity to that calculation. We think that is something that should be reviewed.

Also, as far as the current deficit is concerned, we think the time frame for amortization for 5 years is extraordinarily conservative. If you adopt a new pension plan today you can adopt liabilities over 30 years, and have gains and losses over 15 years. We think that 5 years is inordinately shortsighted in terms of trying to make up that liability.

What we are looking at is a long-term funding situation, and not 5-year funding. I understand, and based on our cursory review of the documents, there is no real justification for the 5-year amortization period.

Senator NICKLES. We appreciate your comments.

Mr. ZEIGLER. That pretty well sums up my comments.

[The prepared statement of Mr. Zeigler follows:]

STATEMENT OF

THE NATIONAL EMPLOYEE BENEFITS INSTITUTE (NEBI)

INTRODUCTION

My name is William H. Zeigler, Director of Compensation and Benefits for Wilson Foods, Inc., which is located in Oklahoma City, Oklahoma. I am testifying on behalf of the National Employee Benefits Institute (NEBI) and I am accompanied by Thomas G. Schendt, the Administrator of the Institute.

NEBI, which represents more than \$25 billion in pension assets, was formed in 1977 to provide members with direct contact to all levels of administrative agencies and departments in Washington. The Fortune 1000 Companies participating in NEBI are leaders with respect to pension planning and are concerned with pension legislation and regulations.

Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) established the Pension Benefit Guaranty Corporation to guarantee the basic retirement benefits of participants in private defined benefit pension plans in the event that a covered plan terminates without sufficient assets to pay those benefits.

It is in the forefront of NEBI's goals to promote the concept of a well funded, fiscally sound, insurance system. Pursuant to these goals, which the premium increase is a major part, we feel that one must look not only at the immediate factors behind the premium increase, but more importantly, at the long-term structural problems that currently exist in the system. We believe that by focusing on the direct relationship

between the premium increase and the overall structural problems a clear, effective, and all encompassing response can be obtained.

NEBI believes that the potential employer costs associated with the future possibilities of substantially large premium increases is a major factor that will defer employers from establishing pension plans. Ultimately, this will effect employees who expect and deserve these benefits.

SUMMARY

To foster a fiscally strong insurance system for the guaranteeing of pension benefits NEBI endorses a well funded program. But as we indicate in our comments we feel that a well funded program does not necessitate a 230% increase in single employer premiums. All the alternatives need closer evaluation before a substantial increase is enacted. We urge you to examine the following aspects of the proposed premium increase which deserve special attention:

1. Of primary importance to NEBI are specific structural problems in the basic insurance program. We believe that a long-term solution can only be developed by addressing the inherent problems in the system. A substantial premium increase is at best only a short-term solution. Thus we believe that if a premium

increase is to be addressed it needs to be associated with legislation that will cite specific structural problems and their solutions.

2. To decrease the deficit one should not look at only a single source of revenue (that source being an increase in the single employer premium). Rather, alternative sources of revenue should be considered (i.e., changes in investment policies) as a viable alternative.
3. Concurrently, a decrease in unnecessary costs that are associated with the current structure should also be examined when addressing the proposed premium increase. The costs associated with the current definition of what constitutes a basic benefit (i.e., subsidized early retirement benefits) merit a detailed cost study.
4. The General Accounting Office's (GAO) expected disclaimer on the estimation of the amount of liability for the present value of guaranteed future benefits and the PBGC's inability to determine a relationship between the level of claim and relevant economic variables question the validity of reliability of the data used in calculating the needed increase.
5. The 5 year amortization period currently suggested by the PBGC needs to be extended.

LONG-TERM STRUCTURAL CHANGES

As we stated earlier, we believe that if one is to address the proposed need for a premium increase an examination and a complete evaluation of the encompassing insurance program is needed. To be consistent, if one is to evaluate the proposed premium increase then one must also evaluate the current format to which the increase is to be applied.

Currently, if the PBGC incurs any loss in meeting the benefit obligations of a terminated pension plan, the employer who sponsored the plan must reimburse the Corporation for its loss in an amount up to 30 percent of the net worth of the employer. The original intent of this provision was to foster a sense of prudence and discipline on the part of the employer in setting benefit levels and meeting the accruing costs of benefit credits, as well as to provide another source of financial stability to the PBGC. What has actually resulted under the current insurance system is the ability on the part of the employer to take advantage of the structural defects of the insurance system.

NEBI believes that current legislation (S1541 sponsored by Senator Don Nickles) is a possible remedy to the problem that the PBGC has by incurring unnecessary unfunded pension liabilities from employers who could abuse the 30% limitation.

Although we do not support the entire bill in its present stage we believe S1541 addresses some of the major structural problems of the Title IV program. There are provisions in the bill that NEBI firmly supports. These are:

1. The postponement of the PBGC's involvement until the plan sponsor is in a liquidation status or is bankrupt.
2. The elimination of the 30% limit of net worth.
3. Permitting the plan sponsor to maintain its relationship, limited to 15 years, with the plan during the full funding of all vested benefits.

S1541 will help to eliminate the current incentive of a few employers to release a payment of 30% of a relatively small net worth, while continuing its existing business relationships without the burden of a large unfunded liability. Most importantly, the bill delays the entry of the plan into PBGC trusteeship and the costs associated with that entry. These ideas deserve further development and study.

NEBI believes that any proposal that is concerned with a premium increase should be associated with legislation that will address the inherent structure of the insurance program because of the basic applicability of the premium to the program.

SOURCES OF REVENUE

To approach a solution that will enhance the financial soundness of the corporation, NEBI believes that a closer examination of all the possible sources of revenue that are available to the PBGC is necessary. These sources are: 1) Single Employer Plan Termination Insurance Premiums. 2) Recovery of Assets from Plan Terminations, and 3) Return From Investments.

RETURNS FROM INVESTMENTS

Returns from investments are directly related to the proposed premium increase because it is a source of revenue for the PBGC (as is the premium). NEBI believes that the return on investments for the PBGC could be an alternative approach to help supplement part of the premium increase.

According to the PBGC's 1981 Annual Report, Investment and Other Income gains (losses) for FY1981 was (\$5,382,000). With this figure Realized & Unrealized gains and (losses) were (\$41,780,000) in FY 1981. Table IV in the PBGC's 1981 Annual Report shows that in the Revolving Funds account (Government Securities) FY1981 showed a return of -1.7% and in the Total Trust Funds account (Commingled Equities) FY1981 showed a return of -2.9%. It seems apparent that a re-evaluation of the corporation's investment policies are merited. If a greater return could be realized the overall premium needed

might be lessened by the added revenue of the investments. In 1980, the PBGC had approximately \$93 million in revenues, of which 24% or \$22 million was from Investments and Other Income.

REDUCTION OF COSTS

The financial viability of the Corporation will improve not only by looking at other sources of revenue, but also by reducing the unnecessary costs associated with the program.

Following this concern we would suggest an examination of the cost impact of guaranteeing benefits beyond its actuarial equivalent. This examination should be conducted prior to, or in connection with examining the premium increase request. It will clarify the issues of concern on a statistical basis. A cost/benefit approach is necessary to determine the current and future credibility of the level of guaranteed benefits.

Section 4022 (b) of the Employee Retirement Income Security Act of 1974 requires the PBGC, as a general rule, to guarantee payment of all basic benefits that have become nonforfeitable (vested) by the terms of the plan prior to the date of plan termination. Since the Act did not specifically set forth which benefits are to be considered basic, regulations on this matter were issued by the PBGC (ERISA S.4022 (a); 29 C.F.R. S.2605.6 (b) (1976) and S.2609 (1976)). Part 2605

pertains to "Guaranteed Benefits" and Part 2609 pertains to "Limitations on Guaranteed Benefits".

Basically these regulations extended the definition of benefits to encompass non-basic benefits (i.e. subsidized early retirement). NEBI considers these extensions of the definition of basic benefits to be of primary importance to the financial problems that the PBGC is currently facing. We suggest that you re-evaluate the definition of basic benefits to determine a fiscally and socially sound level of benefits. The problem arises when benefits are guaranteed to retirees that are normally not administered by all the plans yet all the employers pay the same level of premiums.

VALIDITY OF THE CURRENT AND FUTURE LIABILITIES

It is NEBI's understanding that the very basic factor involving the proposed premium increase is the current deficit of the single employer program. In 1980 this figure was 94.6 million and in 1981 188.8 million. This means that the present values of liabilities currently being guaranteed by the PBGC exceeds the assets of the program by these amounts.

Considering that approximately 51% or \$3.02 of the proposed premium increase is to be used to finance expected future net claims, our Institute believes that further attention be

given to this area. NEBI questions the reliability and validity of this data for two reasons.

- A) PBGC's attempt at determining a relationship between the level of claims and relevant economic variables has been unsuccessful. In the past they failed to show a relationship between the level of net claims and the unemployment rate. NEBI realizes that this relationship is such that it is difficult to develop a firm statistical correlation. We are very supportive of the agency's past efforts in determining a relationship and we encourage them to continue their efforts in determining a relationship and we encourage them to continue their efforts in the future.
- B) The General Accounting Office (GAO) conducted an audit of PBGC's financial statements for the year ending September 30, 1980. The GAO is expected to disclaim an opinion regarding the estimation of the amount of liability for the present value of guaranteed future benefits. By issuing a disclaimer the GAO believes that they have not received sufficient competent evidence to form an opinion on the accuracy of the financial statements.

THE TIME FRAME USED TO AMORTIZE THE CURRENT DEFICIT

About 33% or \$1.59 of the \$6.00 proposed premium is to be used to amortize the expected 1982 deficit over five years. NEBI does not recognize the reasoning behind this particular time frame versus a 10 or 15 year amortization period. By contrast Congress specified in the Internal Revenue Code Section 412, that a single employer plan can amortize unfunded past service liabilities over a thirty year period and net experience losses over a 15 year period. The PBGC has shown that by using a 15 year period of required cost per participant would be 0.98 and the required premium reduced to \$5.00.

Senator NICKLES. Mr. Raskin.

Mr. RASKIN. Thank you.

You have my formal comments, so I am going to try to keep it short.

I just want to tell you a little bit about the association. It has 600 members. These members constitute a cross section of American business. They are both large and small employers in the association, and the issue of proposed increase in the single employer plan termination insurance affects them all, perhaps in different ways.

I want to, instead of referring to my written remarks, I would like to respond to a couple of remarks that were made by Mr. Jones. He described the increases as minimal, and maybe \$6 per year per employee is not all that great. But I would like to point out that the rate of increase has been 25 percent a year. At that rate, in the year 2000, the \$6 premium will be levied on a weekly basis, rather than on an annual basis. At that point we will have a system——

Senator NICKLES. Are you an actuary?

Mr. RASKIN. Yes, I am.

Senator NICKLES. Six dollars would be what, in the year——

Mr. RASKIN. On a weekly basis.

Senator NICKLES. By the year 2000?

Mr. RASKIN. That is right. At that point we will have a system which is going to give us as much social problems as perhaps social security is expected to give us.

I really think that we cannot just take very lightly the fact that the premium is increasing at the rate it is increasing. We have to do something about the system in general. A private carrier—and Mr. Jones alluded to a private carrier, he said the PBGC would not be in such shape if it were a private carrier, and that is correct. It certainly would not.

I do not know of any private carrier that would insure an uninsurable risk, and we have uninsurable risks in the system, and

these uninsurable risks have to do with the possibility of dumping, and I guess a lot of people talked about that. But I want to point out that dumping is going to lead to something else that is bad. It is going to lead to weaker funding, because any employer in his right mind is going to take the assets that he would otherwise have put in his pension plan, and put it in his company.

If the company is in trouble down the road, the PBGC is going to pick it up and absorb the company problems. If the company is fine, then the company has enough of assets to take care of the pension plan. If we want to go that way, we have to make a decision to go to an unfunded basis as they have in certain European countries, but we ought to do that in a systematic way, we should not do that by directing people to direct that through creating a system which is not going to work.

Private insurers would not insure these kinds of events, nor would an insurer, an event in which the employee can receive benefits that are not actuarially equivalent, and we have that on the early retirement provision.

This administration, early on suggested that the social security recipients, at age 62, get 55 percent of the benefits that he would get at age 65. That proposal was withdrawn pretty quickly because of the popular belief that everybody was entitled to the 80 percent benefit.

Most private pension plans provide considerably more than 55 percent of the accrued benefits at age 62. Most of them provide more than 80 percent.

By allowing that benefit to start early, even the actuarial equivalent, when you use the actuarial equivalent of the plan, there is going to be a drawdown on the system. The system should not be used to replace unemployment insurance compensation, or to augment them. We are facing what is really a social system, and we ought to look at what the purpose of the social system was. It is not a private system. It is a social system, and the purpose of this social system was to insure retirement benefits, and those retirement benefits were benefits that would start when people would normally expect to retire.

If Braniff goes out of business, and they have an unreduced pension at age 60, and I do not know what they have, I do not know their plans, or if they have an early retirement program at age 50 or 55, that is not what the system was supposed to insure. It was supposed to insure those pensions when the people would normally expect to retire.

We have another system, unemployment insurance, in this country to help those people over the bridge to get another job. That is really not the function of the PBGC system.

I am going to conclude my remarks with that.

[The prepared statement of Mr. Raskin follows:]

APPWP
Testimony

on

THE PROPOSED INCREASE IN THE
SINGLE EMPLOYER PLAN TERMINATION
INSURANCE PREMIUM

presented by

Richard S. Raskin

My name is Richard S. Raskin. I am a Vice President of George B. Buck Consulting Actuaries, Inc. and its parent company, Buck Consultants. I am here today on behalf of the Association of Private Pension and Welfare Plans.

The Association has 600 members. These members constitute a cross section of American business including both large and small employers. The issue of a proposed increase in the Single Employer Plan Termination Insurance premium concerns both large and small employers, albeit in different ways.

I am not here to dispute the PBGC request for a premium increase on the basis that under the present program it will not be needed. The PBGC has not demonstrated (in its March 1982 background report) the need for an increase in the premium level now, or in the future. It is clear to me, however, that because of inherent problems in the system that increases are and will be needed unless something is done to cure these problems. I will come back to these inherent problems and the magnitude of future increases later.

It is also clear, however, that an increase is not needed in the short run. What is needed instead is a correction of the problems of the system. The PBGC cash flow should be sufficient to meet its needs for the next several years. Correcting the system may well have the effect of making the current \$2.60 premium sufficient.

One should not take lightly the rate of increase in premium in the Single Employer Plan Termination Insurance program. In 1974 that premium was established as \$1.00 per covered employee. It is proposed that that rate be increased to \$6.00 in 1982. On a compounded basis that is a 25% per annum increase and if that increase is continued into the future at the same rate, in the year 2000 the premium will also be \$6.00, but it will be a weekly premium rather than an annual premium. However, long before that, the cost will be viewed as being prohibitive, and at that point, the insurance system will break down.

Let me say unequivocally, the APPWP does not want to see the plan termination insurance program break down. A privately funded, smoothly operating, intelligently designed insurance program is in the interest of all persons connected with private pension plans, including the sponsors of those plans. As a result, it is with mixed emotions that we argue against the adoption of the PBGC request. Certainly no one wants to see the PBGC financially fail. But rather than approve the increase in some perfunctory fashion, it seems appropriate to question whether there are some fundamental flaws in the design of the program, which ought now to be examined and corrected.

In reviewing the design of the termination insurance program, it makes sense to keep in mind some of the fundamental principles of insurance. I would like to paraphrase the remarks of one scholarly

writer concerning "...the conditions which in general are necessary to the successful operation of a system of insurance." They are these:

- (1) a real risk of loss which the insured cannot prevent or cause
- (2) a large number of insureds
- (3) a small number of expected losses
- (4) reasonably predictable losses
- (5) a loss worth insuring, and
- (6) reasonable insurance costs.

Some of these features are characteristic of the present Title IV Termination Insurance program, whereas others are not. Let me focus on just the first, insured's control of the insurable event.

A familiar example of the principle that insurance not be available where the insured can control the risk is seen in the property casualty field in that insurers refuse to pay for losses incurred whenever a property owner hires an arsonist to burn his own building. This type of "control by the insured" also exists within the plan termination insurance program. In July of 1978, the PBGC advised the Congress of this problem as part of its status report on Contingent Employer Liability insurance. More recently, a report on research performed at the Federal Reserve Bank in Boston suggests that the exposure attributable to this design flaw has grown, rather than stabilize or diminish during the past four years. Because of

the existence of employers liability, the PBGC sustains a financial loss only in those situations where an employer's net worth is low in relation to its pension obligation. The net worth test serves to control the risk of loss for financially strong companies. It is with respect to weak companies that our first principle; that the insured not be able to control the occurrence of a loss; breaks down.

Whenever a company has a pension obligation larger than 30% of its net worth, it may be in its interest to turn over that pension obligation to the PBGC in exchange for 30% of its net worth. In effect plan termination insurance may be an unintended business reorganization law, probably reorganization of pension liability:

- without the consent of creditors, in this case other premium payers
- without any limitations on the creation of future liabilities, and
- without any stigma whatsoever.

The ability of weak companies to dump their pension liability on the PBGC is bad bankruptcy law and is bad insurance law. Some employers have begun to use this loop hole in the law and dumped a large remaining unfunded liability into the insurance system. The PBGC has responded to its fear of dumping in two ways. First, it has proposed the premium increase. Second, it has opposed many of these claims in the courts. If, and when it appears the PBGC

cannot resist these claims, there may be a perpetual run on the Bank. It is our view that this fear of an accelerated rate of dumping forms a large part of the \$6.00 premium proposed by the PBGC.

The Association endorses a position that the PBGC insurable event be changed to one of the sponsors bankruptcy or liquidation. This would correct the system by making the plan sponsor accept a larger loss - that of its own business, in order to incur a claim. Thus restoring the original concept of the program as one to guarantee pension to people rather than to relieve marginal firms of their pension obligations. Selling life insurance makes sense because no one wants to die to collect. Selling termination insurance linked to business failure also makes sense as only a few will want to go out of business to beat the system.

Some may point out that limiting the insurable event to employer insolvency may overcompensate for the concerns raised by the current employer control of the insurable event. If insolvency is the only insurable event, then only those businesses that fail and their employees have any effective coverage under Title IV. It makes it difficult to see why employers should pay insurance premiums just to insure the plans of their failing competitors. In fact, limiting the insurable event to employer insolvency clearly reflects that the premium is a tax.

The APPWP believes that it may be possible to structure a workable insurance program which stops short of insuring only those businesses that fail. During the last several months there have been several attempts at this which have not yet met with complete success. Much of this effort has been directed at dividing the universe of insured plans into two groups - small plans and large plans. Unfortunately no one has yet been able to deal adequately with problems created by the changing size of employers and/or plans.

Other effort has been directed toward a two-tiered approach to plan termination insurance devised along lines which relate to the efforts of employers to maintain well funded plans - as opposed to plans not so well funded. Employers interested in coverage broader than just business failure coverage might have the ability to obtain it through earnest programs of more rapid pension funding. APPWP endorses the effort directed to making the system insure employers as well as employees. Our smaller plan sponsors, especially, feel that this is an essential issue, as they must be allowed to terminate their business without PBGC obligation. However, any such effort must protect the system from voluntary abuse.

An ancillary issue subject to much debate is the relative status of the PBGC and other creditors in the event of a Plan sponsors bankruptcy. Here again a more rapid funding test might be used to give creditors a preferred position. Absent some preference for more rapid funding, I see little reason for employers to be concerned about the level of

funding in their pension plans. The program, as it exists today, treats all plans alike - small and large; well funded and broke. On this same point, it also seems to me that the current structure of PBGC's program gives little cause for employees to be concerned about how well funded their pension plan happens to be. The wall-to-wall coverage of Title IV is so generous that most employees rather see funds go to improving benefits, rather than funding ones which already exist. "Who cares, if the company goes broke, the PBGC will pay!" Today, the PBGC guarantees pension of approximately \$1,300 per month, far in excess of levels bargained for under even the richest existing pattern plans. Much too large an amount to be secured by tax dollars. Also the PBGC premium is clearly a tax.

A re-examination of the guarantee philosophy is in order, given the concerns raised by this recent (and alarming) premium request. There appears to be evidence that since the passage of the Multiemployer Pension Plan Amendments Act of 1980, union trustees have taken a new and fresher interest in the percentage of available contributions which are used to fund past benefits. In that bill, guarantees were revised to place a small portion of each employees pension at risk - not just employer assets and premium dollars. We recommend that the Congress consider also making the single employer program one that has the interests of all three parties supporting the program - employers, employees and premium payers.

The Association recognizes that an equitable approach to termination insurance is not simple to achieve. In the end, our concern is to keep the cost of the termination insurance program affordable, in terms of both premium and employer liability. Without change, it is certain that the cost of the current system will be so prohibitive as to force American employers to abandon defined benefit pension programs. These programs are the heart of the retirement system as we know it in this country today and no program should be developed or continued which would jeopardize that system. We must make the program of the Pension Benefit Guaranty Corporation a successful insurance plan so that we are not forced to accept a choice of abandoning the program in its entirety, accepting the program as a new social welfare scheme, or seeing the termination and discontinuance of a large number of defined benefit pension programs.

Senator NICKLES. Thank you.

Mr. Handy.

Mr. HANDY. Senator, we learned this morning about trend line projections, which is a new science as far as I am concerned. It occurs to me if we look back in the history of the PBGC premiums, they started in 1976, as I remember, at \$1, they increased by 260 percent in 2 years, to \$2.60, and then I think the current increase is characterized as 230 percent increase, but the overall increase is 600 percent in 6 years.

If you draw a trend line from that, you get a pretty frightening projection. The NAM is very concerned with the ongoing strength of the insurance system, and the ongoing health of defined benefit plans and both of these are put in jeopardy, unless we can somehow link a strengthening of the system with the premium increase. For that reason we strongly endorse your bill, S. 1541, which seeks to patch the roof before it rains.

I notice that \$3.02 of the proposed premium increase is due to additional claims that are anticipated. I wonder how many of those claims would be anticipated if there were appropriate legislative changes? Another 97 cents is attributable to administrative expenses. I wonder how many of those expenses would be incurred if your bill was passed, and if a lot of the current paperwork that is foisted off on the PBGC could be avoided. Under S. 1541 plans would not come under PBGC jurisdiction until bankruptcy and there should be considerable savings in administration.

I would like to read and emphasize one portion of the statement. I understand this statement will be—

Senator NICKLES. It will be in the record.

Mr. HANDY. We would like to stress particularly the importance of the creditor status of the PBGC in bankruptcy. We would ask

that Congress seek to place in proper context the relationship of pension funds and benefit payments with other concerns of the economy.

For example, in title VI of S. 1541, the status of the PBGC claim in bankruptcy is changed to that of unsecured general creditor. While it cannot be denied that this status can in some cases enhance the ability of the PBGC to collect additional funds for the insurance system, and therefore may have a beneficial effect on premium levels, this policy could well have a profound adverse effect on the ability of certain corporations to borrow money by influencing the circumstances under which credit will be extended.

If the PBGC were suddenly to come to the bargaining table in a debt renegotiation, several outcomes can be predicted. They are, first, the magnitude of the PBGC claim could be such that other creditors would refuse to extend further credit or restructure loans, forcing a company into premature liquidation, and putting employees out of work.

Other creditors could seek to elevate their status vis-a-vis the PBGC claim by becoming secured in the assets of the Corporation. This wish to secure all credit has serious economic consequences, since the free flow of capital is greatly enhanced by the willingness of lenders to accept a general obligation to repay a loan from a borrower, rather than a hard claim on specific tangible corporate assets.

If all other creditors secure their claims, where does that leave the PBGC?

And third, creditors will place covenants in all future loan agreements, which provide for an immediate default, if unfunded pension claims increase, or if certain net worth ratios are exceeded. This would put the pension plan in the unfortunate position of triggering the demise of a parent corporation, since unfunded pension obligations are sensitive to investment performance, and a number of other variables.

In summary, the NAM supports the concept of a guaranteed program for pension benefits. NAM members will pay the premiums required to support a rational and equitable insurance system.

However, before we can consider revising the current \$2.60 per participant, it is essential to take legislative action to block further misuse of the insurance system, review the insuring clause, and assure that the revised system will encourage the formation and continuation of defined benefit pension plans.

Thank you.

[The prepared statement of Mr. Handy follows:]

STATEMENT OF
EDWARD O. HANDY, JR., VICE PRESIDENT-EMPLOYEE BENEFITS
TEXTRON INC.
ON BEHALF OF
THE NATIONAL ASSOCIATION OF MANUFACTURERS
REGARDING
THE PROPOSED INCREASE IN SINGLE EMPLOYER
PLAN TERMINATION INSURANCE PREMIUM
SUBMITTED TO THE
SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE
MAY 19, 1982

Mr. Chairman and members of the Committee, my name is Edward O. Handy, Jr., and I am a Vice President-Employee Benefits of Textron Inc. Accompanying me is Mr. Peter Turza, of the law firm Gibson, Dunn & Crutcher. We are before you today representing the National Association of Manufacturers. The NAM is an organization of nearly 12,000 members of every size and industrial classification located in every state. Our members employ 85 percent of the workers in manufacturing employment and produce over 80 percent of the nation's manufactured goods.

As a large number of our members have one or more retirement plans, the NAM is very interested in any congressional proposal which would affect the treatment of these plans under the Employee Retirement Income Security Act (ERISA) and welcomes this opportunity to comment upon the proposed PBGC premium increase.

It is surely obvious that the proper level of premium for the single-employer insurance program is determinable only in light of the specifics of that system. There is near-universal agreement that the present system is open to flagrant misuse. Hearings were held six months ago on provisions of S. 1541-- supported by the Administration and by the PBGC and now pending before Congress--that addressed these problems of misuse. The essential first step in dealing with the required premium levels is to block these potentials for misuse. A second necessary step is to consider and deal with important policy issues concerning the scope and intent of this insurance program. Only then is it sensible to consider a change in the premium level.

There is a close precedent at hand. In 1979-1980, when the financial soundness of the PBGC's multiemployer program was of widespread concern, there was no thought of maintaining an unsound program without change, and simply charging whatever premium it might require. Instead, the problem was considered at length by the Congress and resolved, by tightening the insurance clause and by blocking misuse. Only then was attention focused on setting a premium to support the reformed system. While the present debate over the multiemployer issue centers on the harsh withdrawal liability which falls on some employers, the financial soundness of the program is not in question.

How is it, therefore, that in 1982 when there is substantial evidence of the financial unsoundness of the PBGC's single employer program, the suggested remedy is simply

increasing the premium? The NAM considers it unwise public policy to ignore the important flaws in the present system during these deliberations.

There is a lesson to learn from the multiemployer solution of 1980: even a technically sound solution of 1980 for the solvency of the insurance system can have grave and some would say unacceptable consequences for the health of the very plans being insured. It is therefore essential to assure the financial soundness of the insurance system in a manner that supports the maintenance and responsible expansion of private pension plans, rather than create pressure for their termination.

The NAM would, therefore, ask that the Congress first consider the potentials for misuse under the present single-employer termination insurance program. They are two-fold. First, present law limits the plan sponsor's obligation at plan termination to 30% of its net worth. When that obligation is small compared with the value of unfunded guaranteed benefits, there is a strong economic incentive to terminate the plan, part with 30% of net worth, and escape from a major portion of the unfunded liability. This unfunded liability is then borne by the insurance system which really means by those plan sponsors who continue to pay the PBGC's premiums. It is worth noting that termination of a pension plan has no necessary connection with termination of the sponsor's business. The sponsor may have a low net worth only temporarily, and may fully expect a much higher net worth in the future. Hence there is good economic reason under present law, and it is perfectly legal, to terminate

a plan when net worth is temporarily low. Further, there are other companies which characteristically have strong earning power but low net worth--professional firms, for example. The existing 30%-of-net-worth cap would allow these firms to pass substantial liabilities onto the insurance systems if they so elect.

Second, an organization with an economically troubled component can avoid the pension obligations of that component by divorce--either selling or spinning off the component, or by separating itself and walking away.

These two forms of misuse have produced over \$100 million of actual liability for the insurance system in the past 18 months. Can the premium payers be expected to continue to accept this ongoing misuse and pay whatever premium is needed to cover it? The NAM thinks not.

There is no question that potential for misuse remains. For example, the April 26 issue of Pension and Investment Age, a trade publication, contains information worthy of note dealing with a study for the Brookings Institute by Alicia H. Munnell of the Federal Reserve Bank of Boston. Ms. Munnell estimates the potential liability that would be placed upon the PBGC if all companies with unfunded pension liabilities in excess of 30% of net worth were to terminate their pension plans. For Ms. Munnell's study, Standard and Poor's Compustat Division screened some 6,000 companies and found 86 that fit this criterion. Ms. Munnell then limited her list to 22 companies that she describes as being in "serious financial condition." The portion of their pension liability transferable to the PBGC

is over \$3 billion. The study states that, "while no one would suggest that all these financially troubled firms will terminate their pension plans, the data does suggest that the PBGC is in a potentially vulnerable position."

The present system collects premiums of \$75 million per year. Clearly there could be serious financial ramifications caused by claims far smaller than \$3 billion. If just the two largest companies on the troubled list were to terminate their pension plans, the present 30%-of-net-worth cap could force PBGC premiums to go as high as \$20 per covered employee. Clearly, the first priority must be to fix the single employer insurance system. After that is accomplished the level of premium needed to support the system can be rationally determined.

S. 1541 resolves these problems by eliminating 30% of net worth as a limit on liability; by allowing the sponsor to continue its association with the plan while all vested benefits are being fully funded, over no more than 15 years; and by restricting the PBGC's active involvement to cases where the sponsor is in bankruptcy or liquidation. This approach would block the voluntary dumping of liabilities onto the insurance system. It also would provide a reasonable interval over which the continuing employer can complete its funding. And it avoids the unnecessary administrative expenses associated with inserting the PBGC into every plan termination, even though only 2% of them are insufficiently funded. NAM therefore heartily endorses this approach.

While the NAM does not support all sections of S.1541 as currently drafted, we understand that efforts are being made to iron out the remaining problems in the near future. Any increase in premium must be linked with these recommended reforms.

During this process, the Congress must also seek to place in proper context the relationship of pension funds and benefit payments with the entire economy. For example, in Title VI of S. 1541 the status of the PBGC claim in bankruptcy is changed to that of unsecured general creditor. While it cannot be denied that this status can in some cases enhance the ability of the PBGC to collect additional funds for the insurance system and therefore may have a beneficial effect on premium levels, this policy could well have a profound adverse effect on the ability of certain corporations to borrow money by influencing the circumstances under which credit will be extended. If the PBGC were suddenly to come to the bargaining table in a debt renegotiation, several outcomes can be predicted. They are:

- (1) The magnitude of the PBGC claim could be such that other creditors would refuse to extend further credit or restructure loans forcing a company into premature liquidation and putting employees out of work;
- (2) Other creditors could seek to elevate their status vis-a-vis the PBGC claim by becoming secured in the assets of the corporation. This wish to secure all credit has serious economic consequences since the free

flow of capital is greatly enhanced by the willingness of lenders to accept a general obligation to repay a loan from a borrower, rather than a hard-claim on specific tangible corporate assets. If all other creditors secure their claims, where does that leave the PBGC?

- (3)* Creditors will place covenants in all future loan agreements which provide for an immediate default if unfunded pension claims increase or if certain net worth ratios are exceeded. This would put the pension plan in the unfortunate position of triggering the demise of a parent corporation, since unfunded pension obligations are sensitive to investment performance and a number of other variables.

The matter of PBGC creditor status is a policy decision which the Congress must make. The plan-sponsor community, including the NAM and other business organizations, believes that a subordinated role is sufficient for a claim. This would not encumber day-to-day financial arrangements and since we are the premium payer community we will pay for the consequences of this policy decision.

Aside from misuse of the present system, there is another policy decision that must be dealt with before any premium increase can be determined. That policy question is the scope and level of benefits which are guaranteed by the PBGC.

At present, a level premium of \$2.60 is paid each year for each participant in the programs even though pension plans vary greatly, both in the liberality of pension benefits and in the presence or absence of non-retirement benefits. For example, one plan may provide only minimal benefits at age 65, while another plan may include a generous formula for normal retirement, liberal provisions for early retirement, and substantial non-retirement benefits as well. ERISA recognized these differences by proposing two insurance programs--one for basic benefits and a separate one for non-basic benefits. The PBGC, through administrative action, has defined basic benefits so broadly that a non-basic benefits program has not been designed or even suggested. As a result, participants in generous pension plans receive substantially more guaranteed benefits for the same premium dollar paid than participants in less liberal plans.

As another point, it should be noted that there is no element of coinsurance in the existing program. There is no financial stake in whether the guaranteed benefits come from the plan's assets or from the insurance system. Further, the identical limit on guaranteed benefits--which is a monthly benefit of over \$1,300 for plans terminating today--applies whether the pension was granted for five years or fifty years of service. By contrast, the 1980 amendments to the multiemployer program define a guaranteed amount for each year of service, and incorporates a coinsurance percentage into that amount.

NAM understands that others in the business community will focus sharply on the proper length of the amortization period necessary for the PBGC to recover the funding for terminated insufficient plans and will defer any comments of that subject to them.

In summary, the NAM supports the concept of a guaranty program for pension benefits. NAM members will pay the premiums required to support a rational and equitable insurance system. However, before we can consider revising the current \$2.60 per participant, it is essential to take legislative action to block further misuse of the insurance system, review the insuring clause, and assure that the revised system will encourage the formation and continuation of defined benefit pension plans.

Senator NICKLES. Thank you, Mr. Handy. I appreciate the gentleman's comments.

A couple of questions.

Mr. Zeigler, I appreciate your comment concerning the legislation that we have. I think I was trying to jot down some of the changes that you have mentioned, but I guess the first one I have is you really feel like a very important reform would be to make the insurable event a way from voluntary termination into insolvency, is that correct?

Mr. ZEIGLER. That is correct. It is my understanding incidentally, on that subject, Mr. Niskanen, who is the former Director of PBGC, proposed that several years ago. In fact, I recall a luncheon meeting when he did that. We were surprised, and disappointed that it did not gain more attention at that time.

Senator NICKLES. We are giving it more attention here this year.

This is one of the things that we are very adamant in, and it is one that we hope to have.

Regarding Wilson Foods, you testified basically in having opposition to the increase going to \$6, without some reforms made.

If you are assessing your compensation package, does this make it more if you had an option of creating another plan, of going away from a defined benefit plan into a different type of compensation schedule?

Mr. ZEIGLER. We are not a General Motors Corp., but we do have some 15,000 persons that the premium is due for under the PBGC program. I would say that—I am sorry, I am not quite sure I understand.

Senator NICKLES. Does the increase in premium make you think we should be looking at defined contribution plans, or target type of plan?

Mr. ZEIGLER. Yes. I would say it is very difficult for a company like Wilson Foods, which is an old line meatpacking company, to convert plans that simply. You have union contracts that have been in existence for many, many years. The meatpacking industry is one of the oldest in the country, and we have gone through some 30 different negotiations, I think, since the union was formed.

I think it would be extremely difficult to change to, say from a defined benefit plan to defined contribution plan, and very similarly, it would be difficult to do that in a salary plan without some change for the hourly employees.

Senator NICKLES. If you had more flexibility, would you be inclined to go that way?

Mr. ZEIGLER. In what regard?

Senator NICKLES. Let us say that you started a new business, not Wilson Co., but Zeigler, Inc., and you wanted to build widgets, and you wanted to have some type of retirement compensation. Which direction would you go?

Mr. ZEIGLER. Yes, if I had my choice, and I were starting a corporation today, I would definitely not consider defined benefit plan.

Senator NICKLES. The reason I was building on that is because they are estimating an increase in the number of participants. We are going to get information from PBGC as far as the number of participants every year, premium increases, and so on, and I think that may show.

Mr. ZEIGLER. Let me rephrase that just a bit, Senator.

I would definitely not consider the defined benefit plan, at least as a first plan for the company. I will put it that way.

I think a defined contribution would be attractive for a new corporation.

Mr. HANDY. Senator, if I might comment on that.

We have about, between 80 and 100 qualified plans——

Senator NICKLES. At Textron?

Mr. HANDY. At Textron. There is no question that the increase in PBGC premium is becoming a factor in our considerations with respect to establishing a new plan for a new unit or a new plant. There is no question that this does become a matter of concern, as does the prospect of administrative expense, in the event that there is a plan termination. There are a lot of encumbrances that have been attached to defined benefit plans that I think your legislation would tend to do away with.

Senator NICKLES. You mentioned your desire to basically get away from a general creditor status to an unsecured or subordinated creditor's status.

I would like the people to know that our committee is working diligently on the legislation, as it concerns creditor status, and we are trying to come up with something workable. Mr. Jones mentioned this morning that he wished to see general creditor status preserved, and we will continue to explore a compromise.

We have worked with many interested parties. We want to do what is best for both the PBGC and the retirement industry as a whole, keeping in mind the effect of one status versus the other.

Mr. Raskin, you stated that it is never the intention of PBGC or Congress to insure "one unemployment benefit." I guess that would

be the plant closings benefits that may be added into basic benefits and also additional, early retirement benefits.

If my plan provided for 80 percent, or 100 percent of retirement benefits at age 62, and that provision has been in effect for 5 years, is PBGC insuring these benefits at age 62?

Mr. RASKIN. They are insuring that.

Are you talking about the unsubsidized benefits? They are insuring the full benefits, up to the limit.

Senator NICKLES. Up to the \$1,300 limit.

Mr. RASKIN. That comes down with actuarial assumptions, but those actuarial assumptions—

Senator NICKLES. That is the limit, though?

Mr. RASKIN. That is right.

Senator NICKLES. If I had a plan that said Mr. Employee at age 62 you get 100 percent, and if that was \$60, they would insure up to \$60 at age 62?

Mr. RASKIN. That is correct.

Senator NICKLES. Not at what—

Mr. RASKIN. What they will insure is the actuarial equivalent.

Senator NICKLES. That is just the maximum amount. If you had an early retirement plan, and those payments were made still less than the actual equivalent of the plan, then you would be able to receive that amount? You could have a 30 year out, as long as you were under that 1382 actuarial figure, and could receive 100 percent at that time?

Mr. RASKIN. That is correct. But I want to point out it is their assumption of what is an actuarial equivalent, and it is not necessarily a real world assumption of what an actuarial assumption is. It is not using the 15-percent interest rate as applying to the next 3 years. It is using the 10 percent interest rate applying to the 7, and then the lower rate for the 8-year period.

Senator NICKLES. Are you saying that you think their calculation for "the liabilities," the deficits, as they have been called today, are too large?

Mr. RASKIN. No, what I am really saying is that the benefits that they are insuring are more than the actuarial equivalent.

Senator NICKLES. If they are allowed to go out and contract today?

Mr. RASKIN. Correct.

Senator NICKLES. As was alluded to by Mr. Zeigler. Would you concur with that, or do you think that would be a possibility where PBGC should be allowed to purchase annuities from private—

Mr. RASKIN. I do not know the answer to that. I think what is going to happen is that if we get the \$6 premium increase, a lot of employers are going to go out and purchase private annuities, and you made a comment about the number of participants, and I think an increase in the premium to \$6 will have the effect of reducing participants, because employers can take out the already required participants and go out and buy annuities from an insurance company, and not have to pay the PBGC \$6.

There are a number of employers, for one reason or another, who have one employee or other covered under two plans. As that gets significant, it is going to pay for them to combine the two plans into one plan. So we are going to start to see a shrinkage that per-

haps nobody has paid any attention to. But as an actuary, if you will, I have a number of clients that have never merged all their plans together because the administrative cost was greater than the premium saving, but it is going to start to go the other way.

Senator NICKLES. Are there not quite a few people thinking, in smaller plans, looking at the cost for the annuities, and purchasing those annuities at today's rates?

Mr. RASKIN. That is correct. I think you are going to see more of that. Even on larger plans, because they are going to save \$6 plus, as they—another expense.

Senator NICKLES. Gentlemen, we thank you very much for your input and testimony before the committee.

Our next witness today is John Sheehan, legislative director of the United Steelworkers of America.

John, welcome again before our committee.

STATEMENT OF JOHN J. SHEEHAN, LEGISLATIVE DIRECTOR, STEELWORKERS OF AMERICA, ACCOMPANIED BY THOMAS DUZAK, DIRECTOR, INSURANCE AND PENSION DEPARTMENT, AND HOWARD KLINE, ESQ., COUNSEL

Mr. SHEEHAN. Thank you, Senator.

I would like to indicate at the beginning that I am accompanied by Mr. Tom Duzak, who is director of our Insurance and Pension Department, the Steelworkers of America; and Howard Kline, who is our benefits counsel, and served for a time here on the House Task Force on Pension Legislation.

Of course, I would like to indicate that I appreciate the opportunity given to us to comment on this issue on the premium increase. It is significant that we are here today. The years since the ERISA bill was passed have been rather difficult ones for the steel industry, and for our members, and we have suffered widespread and prolonged unemployment, currently unemployment in the steel industry is running at 30 percent.

In addition, many steelworkers have lost their jobs—

Senator NICKLES. Is that in the United Steelworkers or the entire steel industry?

Mr. SHEEHAN. That is really in the entire steel industry, but for all practical purposes, that is the same. It is reported by the American Steel Institute, the figure that I just gave you, in their American Metal Market.

In addition—well, without the benefit of the plan termination insurance, thousands of steelworkers would lose not only their jobs, but millions of dollars in pension benefits as well.

In enacting the termination insurance program, Congress determined that workers should be insured against the loss of their pension benefits in the event that their pension plan terminates.

I want to emphasize here that we are talking really of the basic benefits only in light of conversations earlier before this committee, which in our case, the guarantee is covering maybe only about 40 percent of the pension benefits that we have indeed negotiated with our companies, only about 40 percent is being subjected under the definition of the basic benefit, which is then, of course, insured.

Senator NICKLES. Do you mind if I interrupt you? Not wanting to interrupt your statement, but you are saying Congress intent was to cover primarily the basic benefits, and you are saying right now that is all you believe the PBGC is covering, about 40 percent?

Mr. SHEEHAN. But certainly that is correct. Congress intended that only the basic benefit would be covered. It sets up the distinction between the basic and nonbasic benefits. It also recommended in the legislation something that I think has been forgotten, that the nonbasic benefit could also be insured under an option insurance program. It has never been put into place.

I think the controversy, however, is that definition and scope of the non—of the basic benefit—but obviously it is only the basic benefit that is covered, and in our case, and perhaps Tom would like to elaborate more on it in a more recent shutdown, that definition indicates about 40 percent of the benefits could be insured by PBGC.

Senator NICKLES. Where is the difference?

Mr. SHEEHAN. Tom.

Mr. DUZAK. Well, Senator, the law currently insures only basic benefits, and in the case of—

Senator NICKLES. Should that include an early retirement supplement?

Mr. KLINE. Wait. Not a social security. What has been referred to as a social security. A benefits payable, the \$400 and some a month that is payable, between the retirement and commencement of social security, that portion is not guaranteed by the Pension Benefit Guaranty Corporation.

I believe there has been some misunderstanding about that this morning. In the auto workers, for instance—

Mr. DUZAK. Let me give you an example. In the case of steel industry pension plans, we have, over the last 20 years, spent a considerable amount of time building up the kinds of benefits that are triggered in the event of a plant shutdown, or in the event of voluntary early retirement.

In a sense, we have taken wages and applied them to develop a pension agreement. In some cases, rather than take a higher benefit multiplier, we have taken lower amounts in order to—liberalize the benefits so that these benefits would be available in the event a person loses his job.

If, for example, a plant in the steel industry, a plant were to terminate an employee with \$20,000 of creditable pension earnings, age 50, with 30 years of service, if he were to be affected by a shutdown, he would be entitled to an immediate unreduced pension, plus a supplement, a monthly supplement.

Now, you distinguish that monthly supplement from what has been referred to as actuarially supplemented early retirement benefits. His basic benefit would be \$660 a month. He would also be entitled to a \$400 supplemental benefit, payable until age 62. So he would have \$1,160 payable until age 62, and then his benefits for the remainder of his life would be \$640. Because of the application of the phase-in rules, and because of the actuarial reduction of the so-called guaranteed cap, we estimate, and also because the benefits are further reduced, because they are made in joint and sur-

vivor form, over the lives of two people, that \$660 could be reduced down to \$435. Using my example.

Once again, it depends upon the spouse's age, but this is a rough estimate, and so if you compare \$435 with \$1,160, you will see that this individual is receiving only 37 percent of what he expected to receive, as a result of the shutdown.

There is also losses of special early, or special payment benefits, where in lieu of his first 3 months of pension, we provide 13 weeks of vacation pay. That is also wiped off the books, because it is not considered a basic benefit.

Senator NICKLES. Do you think the 13 week vacation pay should be included?

Mr. DUZAK. We fought that battle 4 or 6 years ago, in favor of these benefits being considered, basic benefits. We fought, and submitted comments on the regulations when they were promulgated, back in 1975 or so, and at this point in time we have accepted the PBGC interpretation of what a basic benefit is.

We are not exactly happy with it, but at least as we understand the legal argument, it would be difficult for us to—we think it would be arguable that they could prevail. But the irony, I think, is that now, some people are questioning the PBGC regulation, which has not been questioned, as best we know, since 1975.

Senator NICKLES. OK.

I did not mean to interrupt your presentation.

Go ahead and summarize, if you would, and I might go back into questions.

Mr. SHEEHAN. I think it was important that we did that because of the impression that all pension benefits are somehow being guaranteed, and we noted while we were sitting here today in Mr. O'Brien's testimony, the guarantee of the 100-percent vested benefit up to the current maximum level of \$1,381, essentially represents a complete guarantee of pension benefits. It is that caveat that we are putting on there, that it does not represent a complete guarantee of pension benefits where the termination occurs.

Senator NICKLES. Please finish your statement.

Mr. SHEEHAN. I am now at the point which we indicated that the basic benefit was being guaranteed, and Congress further determined that the cost of this insurance protection should be borne by the pension plans which directly benefit from this insurance.

When Congress established the termination insurance program, it was anticipated that the experience of the program over the years might warrant periodic adjustments in the insurance premium.

Thus, it is fitting that the PBGC has recommended an increase in the single employer premium in order to spread the cost of recently incurred insurance claims among today's plan sponsors. That is a key sentence that we felt we want to emphasize today, because we are not too sure actually the format under which the PBGC is approaching you.

The failure of the PBGC to request an increase in the premium, in light of recent claims experience, would serve to shift the liability for claims already incurred to further generations of plan sponsors and plan participants. The premium schedule to date has

avoided this result, and we do not believe that Congress should now change the basis of title IV to bring about this result in the future.

In other words, if we need it, then put it on the table and let us get it over with. Otherwise you are going to shift a great burden into the future.

Because a premium increase is essential to maintaining the financial soundness and stability of the Pension Benefit Guaranty Corporation's single employer termination insurance program, the USWA supports an increase in the premium.

It should be noted that the more recently announced deficit by PBGC does not suggest a floor in the termination insurance plan program itself. In fact, the deficit does not mean that there is something wrong with the guaranteed protection. It does, however, indicate the value of this insurance protection to workers whose pensions have been terminated.

Given the possibility that the dire state of the economy may persist, we concur with the view of the PBGC that its existing deficit should be amortized over a relatively short period. This goal cannot be achieved unless the premium is increased immediately in terms of congressional action.

According to the PBGC, a premium increase of approximately \$3.40 is necessary to currently fund the PBGC single employer plan liabilities if it is assumed that the PBGC's net claims will continue to increase at the same rate as they have since ERISA was enacted in 1974.

Importantly, \$2 of the proposed new \$6 premium is attributable solely to the cost of amortizing over 5 years the existing deficit for the PBGC single employer termination program.

Thus, nearly 60 percent of the proposed increase in the premium is the cost of funding, in a responsible manner, insurance claims which have already been incurred subsequent to recent pension plans terminations.

The need for this increase, in short, is not the result of defects in the termination insurance program. It is, rather, largely the result of the Reagan recession.

I will stop for one moment here to add the comment about we may be going up to \$6 a week instead of \$6 a month.

I think, Senator, that such a possibility hopefully will never occur. But it does depend greatly upon the state of the economy, and the recent collapse, for instance, of the Braniff Corp., is due to economic circumstances, and nothing that is being proposed before this committee would, in any way, change the facts of that plan, and we might need greater premium increases, if more Braniffs occur, but it is not because of the pension plan itself, but the state of the economy.

We believe the underlying assumptions upon which the PBGC bases its request for an increase of \$3.40 are reasonable. If, at some point in the future, it appeared that a smaller increase were consistent with those assumptions, as well as the goal of currently funding program liabilities, we would favor such an increase.

It should be noted that the higher premium still represents a very small amount of money relative to total labor cost. For example, for employers in the basic steel industry, the proposed \$6 pre-

mium would represent only two-tenths of 1 percent in the annual cost of maintaining a pension plan.

Surely the value to our society of assuring workers that they will not lose their pensions if their pension plan terminates far outweighs the small cost to the employer of maintaining a sound termination insurance program.

Quickly, I think I would conclude here, Senator, with the fact that we do recommend that the procedures spelled out in the law be followed; namely, that a concurrent resolution be presented to the floor of the Senate, such concurrent resolution was spelled out by the authors of the act in 1974.

We do wish to indicate the view that we hope that you do not add this to currently pending bills before this committee, which, as you know, we testified in opposition to in the past, and there is no sense going into that again.

Senator NICKLES. I remember full well your testimony.

Mr. SHEEHAN. OK.

And I think our appreciation has increased this morning, when we heard others begin litany now of how you cut down on the increase in the pension premium; namely, by cutting back on the benefits, even in the bill pending before the committee there is a section in there that—there is an automatic decrease in the benefit if the Congress does not concur in an increase, we found that in 1541, and you heard, of course, this morning, this whole issue of challenging the early retirement benefits protection, you heard the issue of coinsurance being brought up, you heard the issue of the freezing of the COLA, and you heard the issue of applying the multiemployer pension plan decreased in the 100-percent protection.

These, of course, Mr. Chairman, should increase your concern that the PBGC requests do follow the procedure that was really outlined in the act, namely go for a concurrent resolution.

I think these comments would satisfy this morning.

[The prepared statement of Mr. Sheehan follows:]

TESTIMONY
OF
JOHN J. SHEEHAN, LEGISLATIVE DIRECTOR
UNITED STEELWORKERS OF AMERICA

ON
INCREASE IN PENSION BENEFIT GUARANTY CORPORATION
SINGLE EMPLOYER
TERMINATION INSURANCE PREMIUMS

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON LABOR AND HUMAN RESOURCES
SUBCOMMITTEE ON LABOR

MAY 19, 1982

On behalf of the United Steelworkers of America, I would like to thank you for this opportunity to express our support for the recommendation by the Pension Benefit Guaranty Corporation to increase the annual termination insurance premium for single employer pension plans, effective January 1, 1983.

The United Steelworkers of America is deeply committed to the goal of income security for all workers in their retirement. We actively supported the passage of ERISA and were among the staunchest advocates of its plan termination insurance provisions. The years since enactment of ERISA have not been easy ones for our Union. Through three economic recessions our members have suffered widespread and prolonged unemployment. In addition, many Steelworkers have lost their jobs because their employers went out of business, and more business failures can be expected to occur. Without the benefit of plan termination insurance, thousands of Steelworkers would lose not only their jobs, but millions of dollars in pension benefits as well.

Obviously, therefore, the United Steelworkers of America has an important interest in the continuing operation of the plan termination insurance program.

In enacting the termination insurance program, Congress determined that workers should be insured against the loss of their pension benefits in the event that their pension plan terminates. Congress further determined that the cost of this insurance protection should be borne by the pension plans which

directly benefit from this insurance. When Congress established the termination insurance program, it was anticipated that the experience of the program over the years might warrant periodic adjustments in the insurance premium. Thus it is fitting that the PBGC has recommended an increase in the single employer premium in order to spread the cost of recently incurred insurance claims among today's plan sponsors. The failure of the PBGC to request an increase in the premium in light of recent claims experience would serve to shift the liability for claims already incurred to future generations of plan sponsors and plan participants. The premium schedule to date has avoided this result and we do not believe that Congress should now change the basis of Title IV to bring about this result in the future.

CURRENT PREMIUM LEVELS SHOULD BE RAISED

Because a premium increase is essential to maintaining the financial soundness and stability of the Pension Benefit Guaranty Corporation's single employer termination insurance program, the USWA supports an increase in the premium.

Clearly, the existing \$2.60 annual premium, which has been in effect since January 1, 1978, is inadequate. According to the PBGC, the average claim per termination plan since April, 1977 is over \$1 million, compared to an average claim of less than \$300,000 prior to that date. Total annual claims since 1977 have averaged \$62.3 million, compared to an annual average of \$24.7 million prior to 1977. The PBGC deficit for the single employer termination insurance fund increased from \$41.0 million

as of September 30, 1976 to \$188.8 million as of September 30, 1981. The PBGC expects this deficit to increase to approximately \$470 million by the end of fiscal year 1986 if recent trends in plan terminations continue.

It should be noted that this deficit does not suggest a flaw in the termination insurance program. It does, however, indicate the value of this insurance protection to workers whose pension plans have terminated. Given the possibility that the dire state of the economy may persist, we concur with the view of the PBGC that its existing deficit should be amortized over a relatively short period. This goal cannot be achieved unless the premium is increased immediately.

According to the PBGC, a premium increase of approximately \$3.40 is necessary to currently fund the PBGC single employer plan liabilities if it is assumed that the PBGC's net claims will continue to increase at the same rate as they have since ERISA was enacted in 1974. Importantly, \$2.00 of the proposed new \$6.00 premium is attributable solely to the cost of amortizing over five years the existing deficit for the PBGC single employer termination program. Thus nearly 60% of the proposed increase in the premium is the cost of funding in a responsible manner insurance claims which have already been incurred subsequent to recent pension plans terminations.

The need for this increase, in short, is not the result of defects in the termination insurance program. It is, rather, largely the result of the Reagan recession.

We believe the underlying assumptions upon which the PBGC bases its request for an increase of \$3.40 are reasonable. If, at some point in the future, it appeared that a smaller increase were consistent with those assumptions as well as the goal of currently funding program liabilities, we would favor such an increase. It should be noted that the higher premium still represents a very small amount of money relative to total labor cost. For example, for employers in the basic steel industry, the proposed \$6.00 premium would represent only 2/10 of 1% of the annual cost of maintaining a pension plan. Surely the value to our society of assuring workers that they will not lose their pensions if their pension plan terminates far outweighs the small cost to the employer of maintaining a sound termination insurance program.

A good case in point is the termination of the Alan Wood Steel Corporation's pension plans in 1977. The effects of the bankruptcy and subsequent shutdown of the Company's operating facilities were devastating. Several thousand employees lost not only their jobs but their unemployment benefits and insurance coverage as well. Many could never realistically expect to find new employment. However, because of the plan termination insurance, our active and retired employees will receive over \$38 million worth of pension benefits which would otherwise have been lost. Without the benefit of termination insurance, the assets of the Alan Wood Plan would long have been exhausted and the impact on

our retirees, their dependents and the community would have been even more serious.*

CONCURRENT RESOLUTION SHOULD BE USED

As the United Steelworkers of America and others have noted before this Subcommittee, the legislative process as it relates to amendments to ERISA is highly unpredictable, time-consuming and extremely unwieldy. Congress recognized this when it enacted Section 4006(b) of ERISA, which provides that a premium increase may become effective only after Congress approves such increase in the form of a concurrent resolution. We urge the Congress to follow this procedure in considering the pending PBGC recommendation.

We do not believe that the PBGC recommendation should be considered in conjunction with S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981, which is also pending before the Subcommittee. As we testified in November of 1981, the Union opposes the enactment of S. 1541. We do so for three basic reasons:

First, as noted above, the legislative process with respect to ERISA is highly unpredictable and may well result in serious cutbacks in the protections now afforded plan participants and beneficiaries.

Secondly, amendments to ERISA are not necessary at

*Despite the value of this protection, our members lost many more millions of dollars of pension and other retirement benefits which were not guaranteed by the PBGC.

this time. Administrative and compliance problems which arose shortly after the enactment of ERISA in 1974 have to a large degree been satisfactorily addressed administratively.

Finally, many of the provisions in S. 1541, if enacted, would serve to reduce worker protections by weakening key provisions of ERISA relating to reporting, disclosure and fiduciary responsibility.

In addition, we strongly oppose the change S. 1541 would make in the manner in which the level of termination insurance guarantees and premiums are determined.*

We stated in November of last year and we repeat today as the Congress considers the PBGC recommendation to increase insurance premiums that any amendment to ERISA which would increase the possibility that guaranteed benefit levels might be reduced represents a drastic and unconscionable violation of the promise Congress made to workers in 1974 to safeguard their pension benefits.

Accordingly, we disagree with those who suggest that the PBGC recommendation should be used as a "bargaining chip" to enact cutbacks in the worker protections now provided under ERISA. The premium increase should be considered on its own merits. Congress reached this conclusion when it enacted Section 4006(b) of

*At present, guarantee levels are established by law and adjusted upward automatically in response to increases in the cost of living. Increases in the premium are contemplated as the means of funding these guarantees. In contrast, Section 6104 of S. 1541 would provide for an automatic downward adjustment of the guarantee level if Congress failed to reject a report by the PBGC stating that the existing premium rates could not support the existing basis benefit guarantees.

ERISA in 1974. We urge Congress to retain this methodology and consider the premium increase in the form of a concurrent resolution.

It should also be noted that consideration of the premium increase in the form of a concurrent resolution would increase the likelihood of Congressional approval at an early date, thereby permitting the increase to become effective January 1, 1983. According to PBGC, if the increase is delayed even one year, a significantly greater premium would be required to achieve the PBGC funding goals.

In conclusion, I would remind the Subcommittee that in recent months American workers in record numbers have lost their careers, their paychecks, their homes and their savings. Many have lost their self-esteem, their health and even their hopes that the future will provide opportunities to regain what has been lost. The termination insurance program protects workers against the loss of their pensions, thereby increasing the likelihood that workers will be able to retire with dignity and reasonable financial security. In order to strengthen that protection, the United Steelworkers of America urges the Subcommittee to approve an increase in the annual single employer termination insurance premium and to approve the premium increase in the form of a concurrent resolution as provided in Section 4006(b) of ERISA.

Senator NICKLES. Mr. Sheehan, I appreciate your comments.

You mentioned that the \$6 would amount to a very small percentage of payroll.

Mr. SHEEHAN. Two-tenths of 1 percent of the pension costs. That is the \$6.

Senator NICKLES. The \$6 is two-tenths of 1 percent?

Mr. KLINE. It is the annual cost of maintaining a pension plan in the steel industry.

Senator NICKLES. PBGC premium?

Mr. KLINE. Correct.

Senator NICKLES. It was not the total cost of the pension?

Mr. KLINE. No. The \$6 premium would represent only two-tenths of 1 percent of the annual cost to a basic steel company of maintaining a pension plan. That is on a per employee basis.

Senator NICKLES. What is the average payroll—let me reverse that around a little bit.

Mr. DUZAK. I would say for the basic steel industry, depending upon—it varies from company to company, but in making our calculation, we have assumed a cost of approximately \$1.50 an hour for a steel company; the average steel company to maintain its current pension.

Senator NICKLES. What is the total cost per hour? What is your total hourly labor cost if you added all fringes, and so forth in it?

Mr. SHEEHAN. About \$18.

Senator NICKLES. What if two-tenths of 1 percent went all the way up to 5 percent of payroll?

Mr. SHEEHAN. The two-tenths is reference to \$8.50 per hour, not \$18.

Mr. KLINE. It is the two-tenths of the pension cost. The \$1.50 gives you the annual cost in a real rough way to a company of maintaining a pension plan in the basic steel industry. The \$6 is two-tenths of 1 percent of that cost. It is a very small drop in a very big bucket.

Senator NICKLES. Mr. Jones alluded to the same argument, the total payroll is an insignificant part.

Now, you could turn it around. What are the dues?

Mr. SHEEHAN. \$2 a month.

Senator NICKLES. You could basically take your argument and say, well, PBGC premiums could be \$18 a month?

Mr. SHEEHAN. I think one thing we ought to be clear, the figure we are using here, we are not saying this is two-tenths of 1 percent total payroll.

Senator NICKLES. I am with you.

Mr. SHEEHAN. It is just in the pension area. The cost of providing pensions to steelworkers includes not only the payment of the benefit itself, but also the payment of premiums, and the premium, the total premium of \$6, if that is what would happen, that would only represent two-tenths of 1 percent of the total cost of providing pensions to steelworkers. And I would assume if we just took that figure and asked what \$3.40 increase—

Senator NICKLES. That is OK. If you wanted to say this was small, you could say let us have our employees work 1 hour a month and contribute to PBGC. You could be talking about megabucks but still not get to the heart of the problem.

Let me change horses here for a second. Would you give me a copy of you retirement plan; a synopsis of what a person would get when he is age 50?

Do you have a 30 year and out? Full benefits?

Mr. DUZAK. Yes.

Senator NICKLES. You are basically telling me if you have a 30 year and out at age 50, you put in your 30 years, you calculate what would be an average retirement for a person right now if he worked his 30 years and he is 50 years old and ready to retire.

Mr. DUZAK. A person 50 years old and 30 years of service effective August 1, his minimum guarantee—

Senator NICKLES. What would his benefit be?

Mr. DUZAK. The minimum benefit that he could receive under the pension agreement would be \$547 a month. Now, if he happens to have earnings which are higher than normal, he can qualify for a higher benefit under what we call a percentage of pay formula. We have two formulas. One is a flat minimum benefit and then if any higher, a benefit based upon percentage of pay.

For example, as I said before, if an individual had averaged \$20,000 a year over the last 5 years prior to retirement, his benefits would be about \$660.

Senator NICKLES. So let us say an individual in one form or another he had a retirement, he is 50 years old, he puts in his 30 years, he is going to retire, he is getting \$600 a month. Now, if you took the \$13.81, figured it up, actuarial equivalent, all the way back to age 50, it would be considerably less than age 50, is that what you are getting your 40 percent?

Mr. DUZAK. There is no actuarial reduction in our pension requirements.

Senator NICKLES. How much of that \$600 do you think that PBGC should be guaranteeing?

Mr. DUZAK. We say that is a basic benefit and the full amount should be guaranteed, but because of the current limitations on guaranteed benefits, they actuarially reduce back to \$13.81, a current cap, and for an individual aged 50, that amount would be \$483, and then it is further reduced in the event that he is married and a benefit being paid over the lives of two individuals, and we arbitrarily knock off another 10 percent.

Mr. KLINE. Another important element, if it is in the context of a termination, there is frequently a supplement that would be paid; the \$400 a month supplement, and if the plan were to terminate, none of that \$400 would be guaranteed.

So, in the context of a shutdown, as Tom Duzak indicated a few minutes ago, frequently a benefit, if the plan did not terminate, if the company funded the promises that it made of a benefit of \$1,000, \$1,050 payable by the company, only 40 percent or thereabouts would be guaranteed by PBGC. The supplement drops off entirely and then you have these other reductions.

Mr. SHEEHAN. We are making a distinction here that if the plan terminates and then has liability problems and has to go to the PBGC, it is at that point that we get only 40 percent being protected. If the plan does not have to go to PBGC, then we are getting all—we are getting the basic benefit plus the supplement, but there, that is because the private sector company has provided no

funding to pay for that contracted benefit. It is only when they go to the PBGC that the benefit that the steelworker had expected to get now gets shrunk because the law does not protect the total benefit. That is the point we are making. It is not the fact that the 30 years is being actuarially reduced because under the present PBGC ruling, that 30 years remains fully protected except for the fact—and you saw in here somebody—I think you asked the question, how high do the benefits go, and we said it goes to \$13.81. If the steelworker benefits went beyond that, then it would be contracted under the law. And if a benefit also was negotiated within a 5-year period, it would be phased out.

Senator NICKLES. Right.

Just a general question, Mr. Sheehan.

What type of condition are the steelworker plants in today?

Mr. DUZAK. It varies from company to company. I would guess the best answer would be that they are generally in the same condition as most other large pension plans in other industries in most cases.

Senator NICKLES. Are they doing better than minimum funding standards?

Mr. DUZAK. Some pension—some companies, United States Steel, for example, have for years funded in a manner more conservative than what the minimum is required under the law. Some are funding at the minimum and, as a result of that, they are not fully funded but, at the same time, they are able to meet their contractual obligations on an ongoing basis. In the event of a plan termination, of course, of the shutdown benefits and because the 30-year amortization, naturally it is highly unlikely that a plan would be able to satisfy all of its obligations out of its assets. That is why title IV is so important.

Senator NICKLES. Do you think that shutdown benefits should be included as a basic benefit?

Mr. DUZAK. Absolutely. Absolutely.

Senator NICKLES. I would compliment you and say that you may not have gotten your 13 weeks vacation pay, but you did well in shutdowns and also for early retirement supplements. I can tell that you have done your work in the last few years.

I have no further questions. I would appreciate a copy of the contract, and also if you happen to have it, and it is not any work, a status on your major firms, your major pension plans and your assets and liabilities. Maybe it would help us put that in perspective. We are accumulating some data on that.

Mr. SHEEHAN. I would hope also, Senator, in the development of a philosophy here on pensions in the Senate committee, that this reference that pension plans moving into being something like unemployment compensation systems, that that rather simplistic view be given some close scrutiny by your committee because, as Tom has already indicated, many of our negotiated pensions are such that we negotiated them within the realization that this is a shrinking industry, that we are losing capacity, that there is a great deal of pressure by public policy decisionmakers as to what should be the capacity to produce steel in this country, and in taking those adjustment problems into consideration, early retire-

ment is part of that package, but to consider in some flippant way as being unemployment benefits—

Senator NICKLES. Let us say you negotiate a contract that says that XYZ plant will close, that you will receive 60, 70 percent of compensation. Should PBGC insure that type of compensation agreement?

Mr. SHEEHAN. I think, Senator, as Tom Duzak has elaborated, if you were negotiating with your union, you would have so much funds that you were going to allocate to that negotiation, and if indeed in the pension part we either increase the amount of the current pension benefit or we defer it in terms of allocating some of it to the likelihood or the event—

Senator NICKLES. Should that be under minimum funding standards?

Mr. DUZAK. Yes.

Senator NICKLES. We have had other people testify that it was to the detriment of their workers, and we were not looking for that. You are talking about additional benefits. Should you pay or should the company pay additional premiums to cover that additional benefit. You are talking about a supplement to a pension.

Mr. KLINE. I think the ERISA contemplated that the PBGC would try to devise some kind of risk related premium schedule. It has not done that yet and I do not think until it does we are in a position to comment on its validity. There may be some merit to an approach like that. I do not think we have given—

Senator NICKLES. Do you advocate a risk related premium?

Mr. DUZAK. I think we are willing to give a good look at it. I do not think we are in a position to support it, or oppose it at this time.

A couple points should be made. I think, first of all, the employers who are complaining the loudest about the amount of premium increase because they have large employment forces are those that also do provide these early types of benefits so, in a sense, arguably it is risk related. But, more importantly, getting back to your point about unemployment benefits, the point is that when we negotiate, a cost is attributed to pension improvements, based upon actuarial assumptions. And one of those assumptions is when people are withdrawing permanently from their employment and it is a fact because of the early retirement provisions that the average age of retirement is lower than age 65, and we are paying that price in negotiations.

The other point is that they are not like unemployment benefits because once an individual retires, he not only severs his employment relationship permanently, thereby losing all of his seniority rights, whatever, he also loses his right to claim supplemental benefits from the company and he, in some State, the fact that he is drawing a pension, affects adversely his eligibility for State's benefits. So these benefits are there because of the fact that once an individual loses his job permanently, he really loses all hope of ever recovering what he is going to lose in the future by not being able to ultimately retire at age 65 or thereabouts with long service with a company. He is told to find another job, this is all that is left for him. It is not—

Senator NICKLES. A person 50 years old is too old to find another job?

Mr. DUZAK. Well, if you are working in Pittsburgh or in Donora or Youngstown, it is—it is rather difficult to find other employment. You are competing with a large body of job candidates.

Senator NICKLES. Do we not have laws to protect against age discrimination?

Mr. SHEEHAN. No job availability in those communities.

Senator NICKLES. I was just teasing you a little bit.

Thank you very much.

On our next and last panel is Richard Fay representing the Chamber of Commerce of the United States; Paul Jackson representing the National Small Business Association; and Gerald D. Facciani, representing the American Society of Pension Actuaries.

Mr. Fay, do you care to begin?

STATEMENTS OF RICHARD H. FAY, ESQ., REED SMITH SHAW & McCLAY, WASHINGTON, D.C., REPRESENTING THE CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY MICHAEL J. ROMIG, DIRECTOR OF HUMAN RESOURCES AND EMPLOYEE BENEFITS DIVISION FOR THE U.S. CHAMBER; PAUL H. JACKSON, CONSULTING ACTUARY, WYATT CO., WASHINGTON, D.C., REPRESENTING NATIONAL SMALL BUSINESS ASSOCIATION; AND GERALD D. FACCIANI, PRESIDENT, AMERICAN SOCIETY OF PENSION ACTUARIES, WASHINGTON, D.C., A PANEL

Mr. FAY. First, let me introduce on my right my companion, Mike Romig, who is the director of the human resources and employee benefits section for the chamber of commerce.

My name is Richard Fay. I am a lawyer with the law firm of Reed Smith Shaw & McClay. I have, until recently, been a member of the Advisory Committee of the PBGC representing the interests of employers contributing to pension plans.

Senator NICKLES. You recently were? Are you still now?

Mr. FAY. I am serving as a consultant until I'm reappointed or somebody is appointed to replace me.

I am also a member of the human resources and employee benefits section of the U.S. Chamber of Commerce on whose behalf this testimony is presented.

First, let me destroy any suspense my testimony might have by indicating the conclusion of my testimony which is, with perhaps a change of an adjective here or there, the Chamber's position is very similar to the unanimous views of all the spokesmen of the business community opposing the proposed premium increase. This unanimous opposition is interesting because the business community is in fact the ultimate insurer of this system. Therefore we oppose not just because we are concerned with costs, but because we believe that the premium increase at this time is not only not timely but not thoughtful.

First, let me address the issue that delay would hurt the single employer termination system. In fact, the system does not have a deficit as that word is generally understood or as a businessman might understand the word or the way you or I would use the word in balancing our checking account. We are talking about an actuar-

ial projection of the cost of future liabilities. At the present time and for some time in the future, PBGC is awash with cash. So we do have the time. I am not advocating a pay as you go system but I am saying there is no need to be stampeded into doing something because PBGC is now in the process of running out of funds. There is not a deficit as that word is generally understood. It is an actuarial deficit which has to be handled.

Second, even if you take all of PBGC's figures and their assumptions, used to justify a \$6 premium, there is a question. All of the actuaries I've spoken to tell me that there is a lot of give in PBGC's figures so that an increase of \$6, even using their assumptions, is not justified. If you wait until the middle of next year to do something, which is not necessarily the Chamber's position, it is not accurate to say that this delay will result in an automatic increase of 67 cents or something like that in the premium. Actuarial science does not allow for that kind of precision. Those are the kinds of scare comments used to stampede Congress into doing some action that on greater reflection they might not take.

I am not an actuary. Paul Jackson, on my left, will talk about some of the actuarial assumptions used by PBGC.

But just take the 5-year assumption. They say they should fund their unfunded vested benefits over 5 years. This is ironic because ongoing employers cannot fund this liability that quickly. Employers are told that they can only do it through terminating their pensions. I wonder if this is sound policy.

But much more important than the actuarial assumptions, is their economic forecasts which do not agree with the administration's.

But, in any case, much more important than these technical things is the question of whether the system is vulnerable. As PBGC admits it is at risk, and yet, they propose to do nothing about it.

So if we do a premium increase, it will not address what everybody believes to be the greatest source of danger.

The chamber's position is that there should be some sort of—to use a perfectly valid conservative doctrine of linkage, perhaps some sort of premium enhancement, if you wish, with some sort a restructuring of the program so that it addresses fundamental problems, and that is why we support generally the kinds of restructuring that is set forth in your bill.

I would also like to mention that the chamber shares, the same concern as the spokesman for NAM about the credit and status of PBGC. It seems to us that any restructuring of the program must look at the program as a whole, see what is driving the costs up, see what is putting the program at risk, and then try to do something about that. It is not right to go for a premium increase which does not take care of these risks.

The chamber also believes that there is also a need to get back to a discussion of what are basic benefits to be guaranteed. We need to see if we are in fact insuring what was intended, and, as the earlier testimony demonstrated, there are certain supplemental early retirement benefits which are almost unique with a few industries, and are unheard of in most other industries.

Again, it is ironical that a few unusually rich benefit provisions are driving up the cost of the system when these provisions are the main reason why those industries have found it so difficult to reorganize and restructure in order to make them more productive and profitable. They have to terminate because they cannot find the buyers willing to assume those costly benefits. As a result they are now going to have to throw these costs onto other companies in other industries which had the foresight not to accept such costly benefits, and these companies will pick up a pension cost which they could not afford to do for their own employees. What is the policy of that?

So, as I said, the chamber supports linkage; we support looking at the basic structure of the system; we also think that there are other policy considerations e.g. formations of new plans, which the premium increase will just be another nail in the coffin of defined benefits for the small and medium-sized employer. There was the analogy that the premium is no more than the cost of a hamburger, which is a very neat analogy—as far as it goes. The problem is even if you eat nothing but hamburgers, you still have to have one a day. And the businessman is in the same situation. He has daily costs, and he has very limited profit margin, and the cost of carrying these defined benefit plans and all other kinds of benefits add up and cut into that very thin profit margin and, obviously, small employers will continue not to set up defined benefit plans and medium-sized employers will have a further incentive to terminate them and switch to some other plan not subject to the insurance. Is this sound policy?

We used to say that the defined benefit pension plans were the soundest form of qualified plans. Why then are we encouraging a system that, except for the very big and the very rich, where coverage is fairly adequate, are the only ones that can afford a defined benefit plan? We are doing everything that we can to discourage smaller employers from setting up a defined benefit plan. These are just the kind of employers whose employees need that kind of protection the most.

As I said, the chamber supports linkage of premium increase if there has to be one, with restructuring of the title IV. We also encourage you to think about linkage with other reforms contained in your bill, such as the paperwork and prohibited transactions reforms because these reforms address the same problem, i.e. the cost of maintaining these pension programs. All ERISA requirements should be examined to see if they serve a useful purpose. If we reduce the cost of providing pensions then do we not in fact enhance the system, protect the participants and make it possible to provide more benefits?

And on that comment I should probably stop but I will say one more thing. This whole debate reminds me of the dying comments of Gertrude Stein when her companion leaned over and said, "What is the answer?" Ms. Stein weakly replied, "What is the question?" It seems to me that PBGC's proposal is the result of not asking the right kind of questions.

Thank you very much.

[The prepared statement of Mr. Fay follows:]

Chamber of Commerce of the United States of America
Washington

STATEMENT
on
PENSION BENEFIT GUARANTY CORPORATION PREMIUM INCREASE
before the
SUBCOMMITTEE ON LABOR
of the
SENATE COMMITTEE ON LABOR & HUMAN RESOURCES
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Richard H. Fay
May 19, 1982

Good Morning. I am Richard H. Fay and I am a partner with the law firm of Reed Smith Shaw & McClay and until recently I have served on the Advisory Committee for the Pension Benefit Guaranty Corporation charged with the responsibility of "... representing the interests of employers who maintain pension plans ..." Presently, I serve as a consultant to the committee. I am also a member of the Employee Benefits Committee of the U.S. Chamber of Commerce, on whose behalf I appear today. Accompanying me is Michael J. Romig, Director of Human Resources and Employee Benefits Section of the U.S. Chamber of Commerce.

In the testimony which follows I shall explain why the U.S. Chamber of Commerce opposes the request of the Pension Benefit Guaranty Corporation (PBGC) to increase by 230% the premium, or more specifically stated, the pension tax for single employer defined benefit pensions.

PBGC REQUEST

PBGC has recommended that Congress approve a premium increase for the single employer basic pension guarantee insurance program from \$2.60 per participant to \$6.00 per participant to be effective January 1, 1983. This amounts to a 230% increase and follows on the heels of a 1978 increase of 150%.

The PBGC request does not apply to the separate multiemployer guarantee insurance program in which the Congress has limited the premium to \$1.40 per participant and which is scheduled under law to increase to \$1.90 in 1985 and to \$2.60 in 1989.

SERIOUS QUESTIONS RAISED

The PBGC, conscious of the rising number of recession-caused business failures and the prospect of being swamped with insufficiently funded terminated pension plans, is concerned that it may not have sufficient funds to pay guaranteed benefits sometime in the next decade (1990's). To remedy this "long-term" deficit, the PBGC has advanced a "short-term" solution to currently fund, over the next 5 years, all the long term liabilities that the PBGC has incurred. This proposed solution is as flawed as the programs the PBGC is charged with administering.

PBGC refuses to analyze critically the serious defects of the guarantee insurance program. It has chosen to treat the symptoms rather than to curing the causes of its shaky financial straits. It is our recommendation that, before Congress approves any request to increase PBGC premiums, it conduct a full-scale review of the PBGC programs seeking answers to questions such as the following:

- o Is the PBGC request consistent with its Congressional mandate to encourage the formation and continuation of private pension plans and to maintain premiums at the lowest level consistent with PBGC obligations? In this context, what will the effect of the hefty increase be on small companies? Will the higher premium help push troubled companies to decide to terminate their pensions? Indeed, has the PBGC prepared any economic impact analysis of the request?
- o Is a guarantee of benefits over \$15,000 per year excessive? Is it fair to give the same full benefit guarantee to pension plans with sharply different eligibility, vesting, service, and benefit formulas? Indeed, does it make sense for the majority of companies with well-funded pensions to pay the same premium as companies with large unfunded liabilities? Why hasn't the PBGC completed the Congressionally mandated study on risk-related premiums?
- o Why does the PBGC believe that it is actuarially sound to pay off its unfunded terminated pension liabilities over five years when the Congress has decreed in ERISA that it is actuarially sound for ongoing

pensions to pay off their unfunded liabilities over a period as long as 30 years? Stated another way, the PBGC proposal would have employers with continuing pension plans pay off the unfunded pension liabilities of plans terminated by other companies faster than they fund the pensions for their own employees. Is this a wise policy?

- o Why wasn't the premium request linked to offsetting savings that can be achieved by ending current incentives to dump pension liabilities on the insurance program? Should the higher premium be offset by savings to be gained by simplifying the reporting and compliance requirements of ERISA?

CONCLUSION

Since we only recently received notice of the request and have had limited opportunity to review the rationale for the increase, we will submit a detailed analysis for the record.

In any event, it is our contention that the PBGC has failed to address these issues in submitting its request and we urge this subcommittee to delay the premium increase pending a full airing of these important issues by Congress and by the business community, which must underwrite the PBGC programs.

Furthermore, we recommend that the premium increase be held in abeyance until a consensus can be reached on what reforms of the insurance program are warranted and what offsetting savings could be included, e.g., legislative easing of current ERISA paperwork, reporting, and prohibited transaction requirements.

Senator NICKLES. Thank you, Mr. Fay.

Mr. Jackson.

Mr. JACKSON. Thank you, Senator.

The PBGC premium request is based on a number of projected economic events including estimates of interest yields from the year 1982 to the year 2060, estimates of mortality trends over that period, and estimates of business failures.

Underlying the entire process, however, is the fact that these premiums are being levied only on those employers who were good enough to provide their own employees with pensions, and the question of the fairness of the calculation of their premium, it seems to me, is emphasized from time to time. But what is overlooked is the fact that when a case like Braniff, for example, collapses with a potential of multimillion dollar losses for the system, this loss is going to be levied only against those people who provide pensions for their employees. The people who provide the defined contribution pension plans are left off the hook, so to speak. Therefore, regardless of how the premium level is calculated, it may seem unfair to those who get stuck with the bill.

Now, I can examine the same figures that PBGC did. I can also question why, in a period of time when business failures are increasing at an unusual rate, would anybody just draw a straight line and assume that it will go on increasing at the same rate in the future? If one simply takes the average of PBGC's experience, you could knock \$1.25 off their requested premium. If instead of a 5-year amortization, you used 15, which is faster than most private plans, you should knock off another dollar. The result would be a premium below \$4.

The fundamental question is what is it that the PBGC is guaranteeing? There has been discussion today, in part by the steelworkers, supporting the inclusion of those benefits which they have negotiated in their plans as basic benefits. I do not think they were intended as basic benefits by Congress. I sat through 7 or 8 years of hearings during the debate on ERISA, and termination insurance was a last minute item in the last year before enactment. What was intended by a basic benefit was something comparable to social security, that is, something that starts at 65 and is paid for life. There is an arrangement in ERISA for the insuring of benefits in such a manner.

If, for example, the steelworkers felt that plant shut-down benefits should be insured, the PBGC is authorized to set up a nonbasic trust fund to levy whatever premiums are required. For those groups that want that benefit, the union simply includes that in negotiations, and those benefits are provided. At the present time, I think one of the underlying complaints from the business community, and particularly the small business community, is that those people who cannot afford to provide early retirement benefits for their own employees are being asked to support these very generous benefits for some of the others who can afford it.

Also ironic is the fact that there is a limited group of people, after all, who are covered by this termination insurance program. There are an estimated 60,000 workers who are now over age 65 who are denied the basic benefits commencing at age 65 because their pension plan terminated prior to ERISA's enactment in 1974.

It is one thing to say that these people should be excluded because this is insurance. It is ironic, though, to have one group of covered workers requesting more in the way of benefits, and to have PBGC requesting more current funding—which means we want a pile of cash that enables us to sit on the present value of all future benefits to be paid on into the future—while that magnificent funding and those generous benefits are only available to maybe one person out of four. The 60,000 people who have been excluded from PBGC coverage are ones who were paraded before Congress in the first place as the reason why ERISA should be passed. These were workers at Studebaker, at Perkins Machine and Gear, Ballantine Breweries, and so on. I think it is unseemly that a program that denies benefits to large numbers of people simply on the basis of the date that their pension plan happened to terminate should be funded on a rapid basis.

We have some other suggestions that might help in the long run. For example, the maximum benefit which now stands at \$1,380 a month is far in excess of the benefit that many small businesses provide as a pension. The maximum could be frozen at its current level or it could be indexed at only half the cost of living. Minimum funding under ERISA could also be improved. We have had 30-year funding for a good many years in plans that have been in trouble, simply because they have to be amended regularly to improve the benefits. And when the retirees' benefits are improved, the funding for those retiree benefits goes on well past the time that the last retiree collects.

The benefit guarantee could perhaps be phased-in over a longer period than 5 years. For example, in the Braniff situation, the form 5500 for their Teamster plan indicates that the monthly benefit accrual rate from July 1, 1971, through December 31, 1978, was \$8.35 per month per year—

Senator NICKLES. Could you repeat that?

Mr. JACKSON. \$8.35 per month per year of service.

Under the Teamster plan, this covers about half of the Braniff—

Senator NICKLES. When was it?

Mr. JACKSON. From July 1, 1971, through December 31, 1978.

Effective January 1, 1979, the benefit was increased to \$15; January 1, 1980, to \$18; January 1, 1981, to \$22. Even under the present phase-in rules, I estimate that \$17 or \$18 of the \$22 benefit is guaranteed, even though a mere 4 years earlier the benefit unit was only \$8. So, spreading these plan improvements over a slightly longer period of time might also be helpful.

Senator NICKLES. And that increase is phased in from 5 years to more like a 10-year phase in?

Mr. JACKSON. The phase in could apply prospectively to benefit improvements adopted in the future. You could say those improvements will be phased in over 10 years. I am not advocating that benefits should be taken away from people who now have them or people who have already lost benefits under plans already terminated. But, prospectively, the benefits could be controlled somewhat.

Finally, I have recommended for years that PBGC adopt a less restrictive funding scheme than they have presently. The PBGC

now has assets representing about 75 percent of the present value of all future benefits under their programs. What they propose is to collect the remaining 25 percent in a 5-year period and also arrange to collect the total present value of everything terminating in that 5-year period. If you take the Braniff case, just as an illustration, I estimate a possible loss to the PBGC on the order of magnitude of \$50 million. The present value of Braniff's vested benefits on the PBGC basis is probably something like \$200 million. Probably 90 percent of that figure is guaranteed by PBGC which has assets of \$130 million.

Now, the PBGC views this as \$50 million that they need immediately. However, the program is three-quarters funded, i.e., they have three-quarters of the assets on hand that they would ever need. The plan assets, in other words, will pay 75 cents on the dollar of the benefits under the plan until the last person dies. What the PBGC has to pay is the remaining 25 percent. Since PBGC's benefits payouts are currently running around \$10 million, the actual PBGC share next year would be something on the order of magnitude of \$2.5 million with the plan paying the balance. PBGC's view, however, is that they cannot just consider what is needed next year in way of pay outs to Braniff. Instead, PBGC says they need \$2.6 million next year or \$2.5 million. This increases to \$3 million, runs on for 50 or 60 years, and then discounting all of those payments on back to the present time, ends up being \$46 million.

I have heard comments that the social security program is not well funded. It is paying 100 cents on the dollar now in benefit promises, and I assume it will continue to do so for the rest of our lifetimes. But if the PBGC method of financing were to be adopted by the social security system, you would have to increase the social security taxes by something on the order of magnitude of \$2 trillion per year.

Now, expressed in those terms, obviously the U.S. Government is not going to embrace such a change in social security financing. It does indicate, however, that what PBGC is requesting is a little on the high side. And the problem with the whole arrangement, I think, is that while the business community is given no say in regard to the benefit levels, it is asked to write the check whenever more is needed.

In conclusion, I would recommend that PBGC, rather than simply asking for more money, be required to propose some modifications to their program. In this context, some of the decisions that were made early on, such as the decision to include early retirement benefits in the definition of "basic benefits," might be revisited in light of the fact that they really cannot afford it and that some overall control must be exercised.

[The prepared statement of Mr. Jackson follows:]

STATEMENT OF PAUL H. JACKSON ON BEHALF OF NATIONAL SMALL BUSINESS ASSOCIATION
BEFORE THE SUBCOMMITTEE ON LABOR
OF THE SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
HOLDING HEARINGS ON A PENSION BENEFIT GUARANTEE CORPORATION PREMIUM INCREASE
MAY 19, 1982

Mr. Chairman and Members of the Committee:

My name is Paul H. Jackson. I am a consulting actuary with The Wyatt Company and am appearing here today on behalf of the National Small Business Association (NSB), a multi-industry trade association representing approximately 50,000 small business firms nationwide.

The proposal to increase premiums from \$2.60 to \$6.00 per participant for the single employer plan termination insurance program should be considered very, very carefully by Congress. Based on our review of the process involved, we can only conclude that the request is considerably overstated and that a \$3.60 premium should be ample under the circumstances.

Statistical Validity of Premium Request

Most important to bear in mind is the fact that the \$6.00 premium request is based in large part on assumptions and projections regarding events that may or may not occur in the future. As we all know too well, statistical and economic forecasts are unreliable at best. For the set of assumptions selected by PBGC to project its future claims experience, each of us could offer an alternate set of assumptions that would be equally valid or invalid. There is, however, a constructive and justifiable approach to this problem. Section 4002(a)(1) of ERISA charges PBGC with responsibility for encouraging "the continuation and maintenance of voluntary private pension plans for the benefit of their participants". In view of this charge, it would seem sensible for the Administration and Congress to adopt a more realistic set of assumptions for determining the level of the premium increase needed. The point is that premium increases hurt only those employers who are generous enough to establish a pension

plan for their employees. Therefore it would seem logical, and consistent with Congress' stated intent in Section 4002 of ERISA, for the premium increase adopted to be as low as possible in order to minimize the disincentive it provides for employers to continue or establish pension plans. It should not be necessary for PBGC to include a margin of safety in its premium structure because variations in annual claim costs can be absorbed by the \$350,000,000 in trust fund assets currently on hand. Following are some specific criticisms of the assumptions adopted by PBGC in estimating the level of the premium increase.

Our first criticism is that the PBGC statistics as to the likely level of losses are being set in a period during which business failures have risen to the highest level in the last 40 years. Pension plan terminations occur primarily because businesses are in financial difficulty. Because of this, it might be observed that the losses which PBGC can expect to have should be cyclical, rising as business failures increase and falling again as economic conditions improve. Unfortunately, however, PBGC has based its required premium on the assumption that its net claims will continue growing at the same average annual rate that has occurred since the inception of the program. Thus, as the business cycle reaches the bottom and business failures reach the peak, PBGC's projection for the following period will deviate by a considerable margin on the high side from its actual requirements. Were the PBGC to use average claims since the inception of the program, their premium requirements would be reduced by about \$1.24 -- lowering the \$5.94 to \$4.70 per participant.

In addition to the improper assumption that the rate of business failures will continue to increase indefinitely, PBGC has chosen to amortize its unfunded liabilities over a five-year period. Congress does not permit private employers to amortize their own pension liabilities over less than a 10-year period, and, indeed, allows for their amortization over a 30-year period. Were the PBGC to amortize its current deficit over a 15-year period rather than a 5-year period, the required premium would be reduced from \$4.70 to \$3.58.

Need to Restructure the Termination Insurance Program

Aside from the questionable validity of the statistical and financial assumptions upon which the PBGC based its exorbitant premium request, the NSB urges Congress to direct the PBGC to review some decisions made at the outset of the plan termination insurance program. These decisions have contributed in large part to the current high cost of the program. Specifically, Section 4022(b)(5) of ERISA suggests that the intent of Congress in defining a basic benefit in 1974 was to insure a basic benefit which was a pension right intended to commence at age 65 or, if it were in payment status earlier, its actuarial equivalent. As to death benefits and disability benefits in course of payment when a plan terminates, the NSB has no real objection to their being considered basic benefits because (1) their value is probably less than the value of a monthly benefit commencing at 65 for a healthy employee, and (2) eligibility for such benefits is based on personal catastrophes. On the other hand, we find no merit whatever in having a termination insurance program guarantee the generous early retirement benefits provided by some large employers while the small business community is struggling to provide plans with modest benefits commencing at age 65. The PBGC should be instructed to eliminate from the definition of basic benefits the subsidized early retirement rights found in some of the industrial pension programs. If those rights are worth insuring, and they may be, the PBGC is authorized by Section 4022(c) of ERISA to set up separate trust funds for such non-basic benefits. In this way, those employers who wish to provide such insurance together with those union groups which feel it is important, could do so on an elective basis. It is, however, improper to require the small business community, which rarely offers subsidized early retirement benefits in its pension plans, to pay for such benefits as part of the termination insurance program.

Unnecessarily broad benefit guarantees seem particularly unwarranted in view of the fact that workers whose pension plans were terminated before 1974 have been statutorily excluded from the PBGC's benefit guarantees. So long as the program operates with such a restrictive eligibility requirement (excluding many of today's elderly

workers -- the very group whose loss led to the passage of ERISA in the first place), then the program should not incorporate any extra generous benefits for the "lucky" employees whose pension plans just happened to terminate after 1974. Furthermore, a program that excludes the current generation of pension losers should clearly not set the full funding of such a restricted program as the ideal goal.

Other Changes that Would Help Stabilize Plan Termination Costs

In addition to controlling plan termination costs by ridding the basic benefits program of subsidized early retirement benefits, NSB believes that Congress should freeze the maximum benefit at its present level with the proviso that the maximum amount for plans terminating in any year will not be less than the maximum Social Security primary amount available to an individual retiring at age 65 in that year. Such a provision would not solve any short-run problems for PBGC, but in the long run would help control costs by concentrating the coverage on the employee groups with the lowest benefit amounts.

Furthermore, we believe the time has come for Congress to recognize that ERISA minimum funding under which past service liabilities can be spread over a 30-year period is probably too generous and should be phased downward in the future. Specifically, we would recommend that for new plans and plan improvements adopted after 1982, amortization should be completed by the year 2013 or 20 years from the date of improvement, whichever is later. Improved funding in the long run would help control future PBGC losses and premiums.

Pending Single Employer Termination Insurance Legislation

Finally, we cannot help but observe that this premium increase is being suggested to Congress at the very time when changes are being suggested in the single employer termination insurance program that would sharply reduce its value to the owner of a small business. Specifically, the changes being considered in S.1541 would increase the obligation of the sponsoring employer, so long as he is solvent, from the guaranteed

phased-in benefit under ERISA to the full vested benefit. At the same time PBGC would become a general creditor and be given the right, in the case of any bankruptcy, to go back over a period of as much as 10 or 15 years to recapture funds from any employer who sold all or part of a business to the company that went bankrupt. Also, the small businessman would be personally liable for failure to notify PBGC of a variety of transactions. These proposed changes would increase the cost of credit, reduce the available long-term borrowing, impede the sale of the business and leave the owner with the risk of a huge liability. It is ironic that a sharply increased cost should be proposed at the very time when Congress is considering a sharp curtailment in the value of the program to the owners of businesses that provide pensions for their employees.

Senator NICKLES. Thank you very much.

Mr. Facciani?

Mr. FACCIANI. I appreciate the opportunity to testify today, and we have limited our prepared remarks to approximately 5 minutes.

Our position is that no premium increase should be approved until several events occurred, two of which I shall discuss today.

One, the operations of PBGC are restructured to reduce administrative expenses. Two, an analysis of the premium increase request is made by GAO, including an analysis of the impact of PBGC's policy with respect to the investment of monies in the revolving fund on its financial position.

Based on the figures appearing in the PBGC annual reports, \$94.9 million has been spent by PBGC on administrative expenses for the single employer program from the time of inception of PBGC in September 1974 through September 1981. PBGC annual reports indicate that \$177.9 million in benefit payments has been made from the single employer fund from September 1974 through September 1981. However, a substantial portion of that \$177.9 million is funded by plan assets, and would have been paid even if PBGC were not in existence. Table 5 appearing in the PBGC 1981 annual report indicates that approximately 40 percent of the total guaranteed benefit liabilities through September 30, 1981, can be provided by plan assets, with the remaining 60 percent being funded by employer liability payments, 9 percent, and the PBGC, 51 percent. If this 40 percent figure is applied to actual benefit payments through September 30, 1981, and an appropriate deduction, \$71.16 million, is made for benefit payments that can be attributed to plan assets, the benefit payment figure relating to PBGC operations becomes \$106.7 million. When we compare the administrative expenses total of \$94.9 million with the adjusted benefit payments figure of \$106.7 million, we find that it has cost approximately 89 cents to pay out each dollar of benefit payments attributable to the operations of PBGC in the single employer program.

While we recognize the inherent complexities of the program PBGC is administering, we believe such an extraordinary expense ratio is excessive and avoidable, and we have two specific sugges-

tions we feel will substantially reduce the expense of the single employer program.

We suggest that a simplified procedure be implemented to obtain a notice of sufficiency in small plans (less than 100 participants) so that a notice of sufficiency will be automatically issued whenever an enrolled actuary certifies that plan assets are sufficient to pay all vested benefits.

A second change we favor in PBGC operations is the elimination of the filing of the PBGC-1 premium form and having the premiums submitted to the IRS with the appropriate 5500 form.

We believe a GAO analysis is necessary because of doubts as to the reliability of PBGC's figures. It is noted that GAO did not certify the PBGC financial statements for the years 1977 and 1980 when it examined the financial statements.

The bulk of PBGC's assets are held in the revolving funds, which show a negative annualized return of 0.4 percent from 1978 to 1981. Section 4005(a)(b)(3) of ERISA limits the investment of moneys in the revolving funds in excess of current needs to "obligations issued or guaranteed by the United States." PBGC's policy has been to further limit the investment of revolving funds to Treasury bonds, bills and notes, thus excluding potentially higher returns from obligations guaranteed by the United States, such as GNMA and FNMA instruments.

By way of background, we just yesterday obtained through the Freedom of Information Act a document concerning revolving fund investment policy. It is dated May 1, 1975, to the then Acting Executive from John Carlock of the Treasury Department. It states, in part: Director of PBGC.

[The information referred to follows:]

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20530

May 1, 1975

Dear Mr. Schaness:

This refers to your letter of April 18, 1975, in which you express the desire of your Corporation to invest a portion of the Pension Benefit Guaranty Fund in GNMA pass-through certificates.

On April 24 we met with Mr. Norman G. Parsons, your Director of Finance and Administration, and Mr. John MacKinnon of his staff, and discussed thoroughly with them our position regarding the investment of your funds. They asked that we write this letter for the record.

"Our position is that funds generated by Government programs supported by the credit of the United States should be invested exclusively in Treasury obligations. When funds of this kind are invested in obligations issued to finance special programs, at yields higher than Treasury borrowing costs, the higher yields are obtained, quite simply, by arbitraging the credit of the United States. The higher income from investments permits smaller demands on the users, who should be paying the full costs of the program, and these savings to the users are at the expense of the general taxpayers, who are in effect providing a hidden subsidy.

"We do not think that this is a proper way to handle these Government funds; rather any surplus cash should be returned for the benefit of all the taxpayers at the Treasury's borrowing costs. We do not believe that there can be any debate on the soundness of this principle, and Government accounts totaling about \$140 billion are now invested in accordance with it."

For a number of the largest Government accounts - those such as the social security trust funds whose gigantic transactions could not conceivably be carried out through market transactions - the Congress has specified formulas for establishing the interest rates on special non-marketable Treasury obligations issued to the accounts. These formulas

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provide for rates equivalent to market yields on marketable Treasury securities of comparable maturities. For the smaller accounts, where the Congress has not prescribed statutory formulas, the Treasury has recently taken steps to facilitate portfolio management by making available special issues matching every marketable Treasury issue. An account can choose any maturity it wishes, and the rate will be fixed by the market yield on the matching marketable security on the day of investment. Your fund is presently invested in special Treasury bills of this type. If you feel that your needs permit you to use longer maturities (which will, with the present yield curve, provide higher returns), you may of course have them.

Sincerely yours,



John K. Carlock

Mr. Steven E. Schanes
Acting Executive Director
Pension Benefit Guaranty Corporation
P. O. Box 7119
Washington, D. C. 20044

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Mr. FACCIANI. We do not concur with the position taken in this Treasury Department memo.

We note that section 4002(a)(3) of ERISA states that one of the purposes of PBGC is to maintain premiums at the lowest level consistent with carrying out its obligations under title IV. We do not believe the investment policy with respect to the revolving funds has been consistent with this clearly expressed congressional intent.

We believe that it is time to reexamine the PBGC program to make it more efficient and less costly before any premium increase is approved. We believe that prudence dictates that this course be followed.

[Information supplied for the record follows:]

TESTIMONY
ON
PBGC REQUEST
FOR
SINGLE EMPLOYER PREMIUM INCREASE
TO
SIX DOLLARS PER PARTICIPANT

May 19, 1982
American Society of Pension Actuaries
1413 K Street, N.W., Fifth Floor
Washington, D.C. 20005
(202) 737-4360

The American Society of Pension Actuaries is a national professional society whose 1800 members provide actuarial, consulting and administrative services to approximately 25% of the qualified retirement plans in the United States. We appreciate the opportunity to comment on the premium increase request for single employer plans.

Our position is that no premium increase should be approved until three events occur:

- 1) The operations of PBGC are restructured to reduce administrative expenses, which are running at extraordinarily high levels;
- 2) an analysis of the premium increase request is made by GAC, including an analysis of the impact of PBGC's policy with respect to the investment of monies in the revolving fund on its financial position; and
- 3) a report is submitted by PBGC as to the past and projected cost of the subsidized early retirement element of the basic benefit guarantee program to determine the financial impact of more narrowly defining the benefits guaranteed for future single employer plan terminations. Each of these matters will now be discussed in detail.

Based on the figures appearing in the PBGC annual reports (See attached chart, with year to year figures, Exhibit 1), \$94.9 million has been spent by PBGC on administrative expenses for the single employer program from the time of inception of PBGC in September 1974 through September 1981. (Note: The administrative expense figure for 15 months ending 9/30/76 appears as \$9.4 million in the 1976 report and \$9.9 million in the 1977 report for that same 15 month period. We have used the latter number.) We believe the most accurate guide to the administrative costliness of the single employer program is to compare administrative expenses to benefit payments made from the single employer fund during this period, since the essential purpose of PBGC is to pay benefits due under insufficient plans. PBGC annual reports indicate that \$177.9 million in benefit payments has been made from the single employer fund from September 1974 through September 1981. (Note: The benefit payment figure for 12 months ending 9/30/78 appears as \$23.1 million in the 1978 report and \$28.1 million in the 1979 report for the same period. We have used the latter number.) However, a substantial portion of that \$177.9 million is funded by plan assets, and would have been paid even if PBGC were not in existence. Table 5 (Claims Experience by Fiscal Year Single Employer Program, Exhibit 2) appearing in the PBGC 1981 annual report indicates that approximately 40% of the total guaranteed benefit liabilities through September 30, 1981 can be provided by plan assets, with the remaining 60% being funded by employer liability payments (9%) and the PBGC (51%). If this 40% figure is applied to actual benefit payments through September 30, 1981, and an appropriate deduction (\$71.16 million) is made for benefit payments that can be attributed to plan assets, the benefit payment figure relating to PBGC operations becomes \$106.7 million. When we compare the administrative expenses total of \$94.9 million with the adjusted benefit payments figure of \$106.7 million, we find that it has cost approximately 89 cents to pay out each dollar of benefit payments attributable to the operations of PBGC in the single employer program.

While we recognize the inherent complexities of the program PBGC is administering, we believe such an extraordinary expense ratio is excessive and avoidable, and we have two specific suggestions we feel will substantially reduce the expense of the single employer program.

The vast percentage of terminating single employer plans have had sufficient assets to pay guaranteed benefits. Statistics in the Analysis of Single Employer Defined Benefit Plan Terminations, 1978, issued by PBGC in May, 1981, show that of the 20,900 plans terminating from 1975 through 1978, 20,500, or 98% of the total, were sufficient. This same booklet states that more than three-fourths of the ongoing plans had fewer than

100 participants, but that terminating plans on average were less than half the size of ongoing plans. Thus, it is apparent that the overwhelming percentage of terminating plans were small, sufficient plans, all of which have gone through a complex procedure to obtain a notice of sufficiency, a procedure which has been costly to PBGC and costly for employers terminating small, sufficient plans. We suggest that a simplified procedure be implemented to obtain a notice of sufficiency in small plans (less than 100 participants) so that a notice of sufficiency will be automatically issued whenever an Enrolled Actuary certifies that plan assets are sufficient to pay all vested benefits. We believe such a certification by an Enrolled Actuary provides an ample basis for PBGC to issue a sufficiency notice. It must be remembered that PBGC guarantees do not extend to all vested benefits, so that a plan with sufficient assets to pay all vested benefits would very clearly have sufficient assets to pay all guaranteed benefits. It must also be kept in mind that Enrolled Actuary status is only obtained after passage of a very rigorous examination program and meeting a substantial experience requirement. Furthermore, limiting this procedure to plans with less than 100 participants would provide an additional significant degree of protection to PBGC since the size of the plan would ensure that no huge sums are involved should an Enrolled Actuary err in his or her certification as to sufficiency. We would be happy to work with PBGC to implement this simplified processing procedure for small, sufficient plans.

While we cannot provide specific figures, we believe such a change in processing procedures as we have described would result in multi-million dollar savings each year to PBGC. To illustrate the magnitude of the potential savings, the Office of Program Operations, most of whose time is spent processing sufficient plans, now employs approximately 180 people of a total PBGC staff of approximately 440 persons.

A second change we favor in PBGC operations is the elimination of the filing of the PBGC-1 premium form and having the premiums submitted to the IRS with the appropriate 5500 Form. We believe the PBGC-1 Form is unnecessary, is costing a good deal of money to process, and that the premiums can be collected a lot less expensively in the manner we have suggested. Plan sponsors, as well as PBGC, would save money from this change in procedure. Although we do not believe the magnitude of the savings from this premium collection change would be as significant as that which would result from changing the procedures for the issuance of sufficiency notices in small plans, significant savings would still result.

The second condition we believe should occur before any premium increase is granted is that GAO should be requested to conduct an analysis of the premium request, including an analysis of PBGC's policy with respect to the investment of monies in the revolving funds. We believe such a GAO analysis is necessary because of doubts as to the reliability of PBGC's figures. It is noted that GAO did not certify the PBGC financial statements for the years 1977 and 1980 when it examined the financial statements. The PBGC 1980 annual report states in part, in the introduction to combined financial statements, that "On May 3, 1979, the General Accounting Office issued a disclaimer of opinion on the statements for the period ending September 30, 1977, due to the materiality and attendant uncertainties of amounts shown as assets of terminated plans not in PBGC trusteeship, employer liability owed to PBGC, and the estimated net claims for pending terminations. We are informed that the GAO, in connection with the audit of the statements for the year ended September 30, 1980, intends to issue a disclaimer of opinion principally due to the estimating of amounts for the present value of future benefits and to a lesser extent other line items on the financial statements." The critical relationship of the estimate of amounts for the liability for future benefits to the need for a premium increase is obvious.

PBGC's investment experience with respect to its Trust Funds which are invested in the private sector has been good. The 1981 PBGC annual report shows an 11.9% annualized return from fiscal 1978-1981, exceeding the Standard & Poor 500 annualized return and the New York Stock Exchange Index annualized return for that period. However, the bulk of PBGC's assets are held in the Revolving Funds, which show a negative annualized return of -4% from 1978-1981. (See Table IV from 1981 PBGC annual report, Exhibit 3.) Section 4005(a)(b)(3) of ERISA limits the investment of monies in the Revolving Funds in excess of current needs to "obligations issued or guaranteed by the United States." PBGC's policy has been to further limit the investment of Revolving fund assets to Treasury bond, bills, and notes, thus excluding potentially higher returns from obligations guaranteed by the United States, such as GNMA and FNMA instruments. We think such a restriction is unnecessary and has needlessly inhibited the range of available investments. While the additional percentage return available from such instruments may not be large, it should be remembered that, as of September 30, 1981, PBGC has approximately \$170 million (at market value) of the single employer fund invested in government securities, and that what may appear as a small additional percentage return on such investments would add a considerable sum to PBGC's income each year. We suggest that the policy of excluding investments in GNMA, FNMA and other instruments guaranteed by the United States be reviewed by GAO to determine the impact on PBGC's financial position.

The third condition we believe should occur before any premium increase is approved is the costing out of the guarantee of subsidized early retirement benefits which PBGC has made part of the basic benefits guarantee program. By way of background, ERISA provided that PBGC shall guarantee "basic benefits" and authorized it to establish a separate program to guarantee non-basic benefits. In fact what has occurred is that PBGC has adopted a very broad definition of what is guaranteed as a basic benefit and has not adopted a non-basic benefit guarantee program. We note the statement relative to early retirement benefit guarantees in the preamble to the guaranteed benefits regulation published in the Federal Register on September 22, 1975 (29 CFR Part 2605) that "The Advisory Committee also considered and rejected both alternatives contained in the proposal for the reasons given in the comments, and suggested that all nonforfeitable early retirement benefits should be guaranteed to the same extent as normal retirement benefits in order to remedy the problems proposed by the alternatives and in recognition that generally the needs of early retirees for income maintenance are similar to the needs of normal age retirees." While we sympathize with the statement about the needs of early retirees, we do not find any discussion of cost, or whether this is truly a basic benefit, or more appropriately is a part of a non-basic program. In view of the growing liabilities of PBGC, we believe this is an issue that requires examination. We are not suggesting that any benefit currently in pay status be reduced. What we are suggesting is that the definition of basic benefits be reviewed in terms of future terminations.

PBGC's financial problems are long term, not immediate. Thus, there is time to reexamine the program in an effort to make it more efficient and less costly before any premium increase is approved. We believe prudence dictates that this course be followed.

EXHIBIT 1

SINGLE EMPLOYER FUND
(In Millions of Dollars)

	Administrative Expenses	Benefit Payments
1975 (10 Months) 9/2/74 - 6/30/75	2.8	1.5
1976 (15 Months) 7/1/75 - 9/30/76	9.9 ¹	9.5
1977 (12 Months)	12.0	13.0
1978 (12 Months)	14.0	28.1 ²
1979 (12 Months)	15.8	32.3
1980 (12 Months)	19.8	36.7
1981 (12 Months)	20.6	56.8

¹This figure appears as 9.4 million in 1976 PBGC annual report and 9.9 million in financial highlights section of 1977 report for the same period. We have utilized the number appearing in the later report.

²This figure appears as 23.1 million in 1978 annual report, but appears as 28.1 million in financial highlights section of 1979 annual report in for the same period. We have utilized the number appearing in the later report.

EXHIBIT 2

Table 5
Claims Experience by Fiscal Year¹
Single-Employer Program
 (Dollars in millions)

Date of Termination	No. of Plans	Guaranteed Benefit Liabilities	Plan Assets	Employer Liability ²	Net Claims	Percent of Total Net Claims
7/1/74-6/30/75	98	\$ 58.9	\$ 18.8	\$ 5.6	\$ 34.5	100.0%
7/1/75-6/30/76	172	87.1	43.4	27.9	15.7	4.8
10/1/76-9/30/77	136	52.9	21.5	6.9	24.5	7.1
10/1/77-9/30/78	99	125.3	44.5	7.0	73.9	21.4
10/1/78-9/30/79	79	88.2	35.3	4.6	48.4	14.0
10/1/79-9/30/80	97	138.6	65.0	2.9	70.7	20.5
10/1/80-9/30/81	102	129.4	46.8	5.2	77.3	22.4
Total	783	\$680.4	\$275.3	\$60.1	\$345.0	100.0%

¹ The data presented is as of the date of plan termination using data as it existed at the time of the FY 81 Closing. The amounts reflected here are not entirely consistent with the amounts originally reported, because of revised estimates of previously reported claims. The FY 81 Reserve for Pending Terminations is not reflected in these figures. Those plans which are pending termination represent a net claim of \$78 million.

² After deductions for uncollectability of the statutory liability. For detailed explanation, see Note 20 of the footnotes to the Corporation's Financial Statements.

EXHIBIT 3

Table IV.

	Fiscal Year 1981	Fiscal Year 1980	From Fiscal 1978-1981 Annualized
Revolving Funds — Government Securities	- 1.7%	- 7.2%	- 4%
Total Trust Funds — Commingled Equities	- 2.9%	+ 26.6%	+ 11.9%
Corporate Bond Index (Salomon Bros. High-Grade Long-Term)	- 11.2%	- 11.4%	- 5.1%
S&P 500	- 3.1%	+ 21.3%	+ 10.3%
New York Stock Exchange Index	- 2.9%	+ 22.8%	+ 11.8%

Liquidation of Insurance Contracts

In accepting trusteeship of terminated pension plans, PBGC assumes various types of insurance annuity contracts. These insurance contracts were purchased by the plan sponsor to fund some of the promised retirement benefits. While these insurance contracts are guaranteed by the insurance carrier to provide specified rates of return, those returns are

almost always significantly below current market rates. Although some of the insurance contracts allow for some earnings enhancement by participation in the carrier's overall investment performance, the historical returns on the insurance contracts have been shown to generally trail returns available on other, more flexible investment programs.

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Senator NICKLES. Thank you very much.

A couple of questions.

Mr. Jackson, on your \$2 trillion a year, what is the unfunded liability of the social security system?

Mr. JACKSON. Something on the order of \$7 or \$8 trillion. We found those numbers when they are that large—

Senator NICKLES. I was interested in that when you said \$2 trillion a year, and I was assuming that was for a 5-year period of time. The present value would be \$7 or \$8 trillion?

Mr. JACKSON. Yes.

Senator NICKLES. How many zeroes in a trillion?

Mr. JACKSON. Well, we worked in scientific numbers. Twelve zeroes.

Senator NICKLES. I am appreciative of the comments, Mr. Fay, that you made, and also Mr. Jackson, concerning the need for some reform. It is also my contention that we want to do everything we possibly can do to have the linkage, but before we pass these types of increases we will have some of these reforms. This was confirmed by the testimony of PBGC today. I believe they stated if reforms were not made, even additional premium increases would not help. We do not make reform of \$6 look cheap.

That just reinforces my resolve to see if we cannot make them and make some changes as soon as possible.

There were some outstanding suggestions made by many of our panelists today, and we certainly will review those and work with the individuals involved as much as possible to see if we cannot get some of them made before the end of this session.

I thank you very much for your input. I would like to ask all of our panelists to remain responsive to specific requests for information from our committee for the record, if that would be permitted. I would appreciate it.

This meeting is adjourned.

[Whereupon, at 1:20 p.m., the subcommittee adjourned.]

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